By Robert C. Meyer

Most Unscheduled Debts May Be Discharged

Common sense would dictate that any creditor who had no knowledge of the bankruptcy, because the creditor was not included in the debtor's bankruptcy schedules and therefore was not noticed of the case, would not have its debt be subjected to the bankruptcy discharge. Oh, if only Bankruptcy Code statutes were so easily discernible. Unfortunately, this issue encompasses ambiguous clauses that create reasonable differences of opinion and a split among the courts.

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Simple Duty

In bankruptcy, a debtor is obligated to give notice to creditors[1] — a simple and relatively inexpensive task. Given the fact that many large institutional lenders are common creditors, most creditors' addresses are also easily found with modern-day technology.[2] Because of such fact, it is not burdensome for the debtor to meet his/her duty to list creditors.

The Statute

Section 523(a) reads as follows:

> A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> (3) neither listed nor scheduled under section 521(a)(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 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.[3]

This statute's first problematic clause starts with "in time to permit —." Following that clause, two circumstances arise: (1) debts are of a dischargeable nature;[4] and (2) debts are of a nondischargeable nature.[5] Each of those circumstances importantly refers to a "timely filing of a proof of claim." A review of those circumstances and associated clauses follows. In bankruptcy, there are three tiers of creditors, which will be discussed in this article.

Dischargeable Debt Creditors

The first tier includes dischargeable debts by parties who are neither statutorily protected nor included in 11 U.S.C. § 523(a)(2)(4) or (6) — the garden-variety unsecured creditors, who, when not noticed, fall within § 523(a)(3)(A). In a no-asset case, had these creditors been noticed of the bankruptcy, they would have likely closed their file, *as most often no claims bar date is created*. In an asset case, had these creditors been noticed of the bankruptcy, they would have likely filed a proof of claim before the claims bar date established by the clerk, and after filing the claim, they would have likely closed their file.

Nondischargeable Debt Creditors

The second tier are those debts referenced in § 523(a)(2)(4) or (6), who, when not noticed, fall within § 523(a)(3)(B). These creditors have to file an adversarial lawsuit in order to have a court adjudicate that their debt is "excepted" from discharge. In a no-asset case, had these creditors been noticed of the bankruptcy, they likely would have contacted a legal professional and become informed that they had a right to seek exception from discharge for their debt, but at a significant expense. After a cost analysis, these creditors would either file an adversary proceeding or close their file. Only in asset cases (where the clerk creates a claims bar date) would the creditor's efforts also include the filing of a proof of claim.

1 Section 521 states that a 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 [emphasis added]."

2 Including the major credit-reporting agencies, as creditors may often deliver notice to a creditor whom the client may have forgotten.

3 Section 523(a)(3) of the House amendment is derived from the Senate amendment. The provision is intended to overrule *Birkett v. Columbia Bank*, 195 U.S. 345, 25 S. Ct. 38, 49 L. Ed. 231, 12 Am. Bankr. Rep. 691 (1904).

4 Those of a kind specified in paragraphs (2), (4) or (6).

5 Those not of a kind specified in paragraphs (2), (4) or (6) (double negative makes reading this clause difficult).

"Other" Nondischargeable Debt Creditors

The third tier consists of the statutorily "excepted" debts listed in § 523(a)(1), (5), (7), (8), (9), (10), (11), (12), (13), (14), (14A), (14B), (15), (16), (17), (18) and (19). These creditors do *not* need to file an adversarial complaint for their debt to be excepted from discharge. Whether scheduled or not, the debt owed to these creditors will *not* be discharged. Whether a claims bar date exists or does not exist, these creditors' debts will not be discharged.

Discharge of the Unnoticed Otherwise-Dischargeable Debt

The statute includes some confusing clauses. For example, § 523(a)(3)(A) addresses the unscheduled creditor not having its debt discharged when the creditor had neither knowledge of the case and did not have the ability to timely file a proof of claim. The latter part of that conjunctive clause leaves the following argument open: What if the debtor had a "no asset" case, which meant that no proof-of-claim deadline existed? The answer to this question delivers debate among the courts.

Some courts refuse to apply § 523(a)(3) in no-asset cases because there was no deadline to file a proof of claim.[6] When one of the two elements is missing, § 523(a)(3) does not apply.[7] These courts only address the discharge exception of § 523(a)(3) when having a deadline to file a proof of claim exists.[8] An exception may arise if it is determined that the unscheduled dischargeable debt in a no-asset case (without a claims bar date) was omitted because of fraud, deceit or other inequitable behavior by the debtor.[9] Without proof of an intentional fraudulent omission, some courts will not open the case to discharge the debt, as they deem the debt to already have been discharged.[10] This conclusion might trouble parochial due-process followers.

In those courts that apply § 523(a)(3)(A) to no-asset cases, an equitable remedy is often employed to allow the debtor to reopen the case to notice the unscheduled creditor and offer the creditor time to assert a claim to deny or except the discharge. In no-asset cases, nonfraudulently overlooked, unscheduled debts will only be nondischargeable in jurisdictions where § 523(a)(3)(A) is applied to no-asset cases *and* the courts prohibit motions to reopen the case to provide an adversary proceeding to end all debate about the debt's being dischargeable. These jurisdictions are rare.

6 *Compare Judd v. Wolfe*, 78 F.3d 110 (3d Cir. 1996) (§ 523(a)(3)(A) does not apply in no-asset chapter 7 cases), *with Colonial Sur. Co. v. Weizman*, 564 F.3d 526 (1st Cir. 2009) (§ 523(a)(3)(A) applies in no-asset chapter 7 cases).

7 "[T]he debtor's state of mind is not relevant to whether an unscheduled debt that was otherwise nondischargeable under section 523(a)(2), (4), or (6) was nonetheless discharged pursuant to section 523(a)(3)(B)." *Tidwell v. Smith (In re Smith)*, 582 F.3d 767, 778 n.4 (7th Cir. 2009).

8 *Stone v. Caplan (In re Stone)*, 10 F.3d 285, 291 (5th Cir. 1994) (collecting cases for proposition that "a court should not discharge a debt under section 523(a)(3)(A) if the debtor's failure to schedule that debt was due to intentional design, fraud, or improper motive").

9 *In re Baitcher*, 781 F.2d 1529, 1534 (11th Cir. 1986); *In re Stark*, 717 F.2d 322, 323 (7th Cir. 1983) (bankruptcy court should exercise its equitable powers with respect to substance and not technical considerations that will prevent substantial justice); *Perez v. Cumberland Farms*, 213 B.R. 622 (D. Mass. 1997); *Tidwell v. Smith (In re Smith)*, 582 F.3d 767, 778 n.4 (7th Cir. 2009); Lauren A. Helbling & Christopher M. Klein, "The Emerging Harmless Innocent Omission Defense to Nondischargeability Under Bankruptcy Code § 523(a)(3)(A): Making Sense of the Confusion over Reopening Cases and Amending Schedules to Add Omitted Debts," 69 *Am. Bankr. L. J.* 33 (1995).

10 "Thus, in a no-asset Chapter 7 case where no bar date has been set, we conclude that there would be no purpose served by reopening a case to add an omitted creditor to the bankrupt's schedules." *Judd v. Wolfe (In re Judd)*, 78 F.3d 110, 115 (3d Cir. 1996).

continued on page 82

Comparing the Old Law and Newer Law

Old Law		
No Claims Bar Date	Nondischargeable	*Birkett v. Columbia Bank*, 195 U.S. 345 (1904).
Claims Bar Date	Nondischargeable	*Birkett v. Columbia Bank*, 195 U.S. 345 (1904).

Newer Law		
No Claims Bar Date	Dischargeable Nondischargeable if:	Unambiguous language but still dischargeable: *Purcell v. Kahn (In re Purcell)*, 362 B.R. 465 (Bankr. E.D. Cal. 2007). Always dischargeable: *Judd v. Wolfe*, 78 F.3d 110 (3d Cir. 1996). State of mind irrelevant: *Tidwell v. Smith (In re Smith)*, 582 F.3d 767 (7th Cir. 2009). Bad state of mind: *Stone v. Caplan (In re Stone)*, 10 F.3d 285 (5th Cir. 1994).
		OTHER METHODS TO HANDLE THE ISSUE
Claims Bar Date	Dischargeable if:	Exceptional circumstances: *Robinson v. Mann*, 339 F.2d 547 (5th Cir. 1964).
Claims Bar Date	Dischargeable if:	Solely caused by negligence or inadvertence: *Stone v. Caplan (In re Stone)*, 10 F.3d 285 (5th Cir. 1994).
Claims Bar Date	Dischargeable if:	Reopened and the creditor offered opportunity to be heard: *In re Muhammed*, 536 B.R. 351 (Bankr. E.D.N.Y. 2015).
Claims Bar Date	Dischargeable if:	"Balancing test" requires equity: *Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 113 S. Ct. 1489 (1993).
Claims Bar Date	Dischargeable if:	Section 726(a)(2)(C) holistic view: *Leadbetter v. Snyder (In re Snyder)*, 544 B.R. 905 (Bankr. M.D. Fla. 2016).
Claims Bar Date	Dischargeable if:	Cannot prove claim is § 523(a)(2)(4) or (6) claim: *In re Lochrie*, 78 B.R. 257 (B.A.P. 9th Cir. 1987).
Claims Bar Date	Dischargeable if:	Equitable powers trigger § 350: *In re Muhammed*, 536 B.R. 351 (Bankr. E.D.N.Y. 2015).
Claims Bar Date	Dischargeable if:	State of mind irrelevant.
Claims Bar Date	Dischargeable if:	Declaratory action found in the debtor's favor: *In re Guseck*, 310 B.R. 400 (Bankr. E.D. Wis. 2004).
		UNAMBIGUOUS LANGUAGE COURTS
Claims Bar Date	Nondischargeable if:	Language is unambiguous: *Purcell v. Khan (In re Purcell)*, 362 B.R. 465 (Bankr. E.D. Cal. 2007).

from page 63

The remainder of this article will deal with omitted creditors in asset cases or cases that had a claims bar date. Because the deadline to file a claim is specifically the second element of § 523(a)(3)(A) and (B), application of § 523(a)(3) is best reviewed in circumstances where the underlying case includes the lost opportunity to file a proof of claim.

Supreme Court's *Birkett*

At one time, all unscheduled debt was not discharged. The U.S. Supreme Court strictly ruled in *Birkett*[11] that no notice to the creditor meant no discharge for the debtor. At that time, § 17(a)(3) of the Bankruptcy Act had a provision that was similar, but not identical, to § 523(a)(3).[12] Creditors prevailed if the creditor's knowledge was not "in time to avail a creditor of the benefits of the law — in time to give him an equal opportunity with other creditors." This iron-fisted precedent evolved to even prohibit discharge for unscheduled creditors' debt, even when the creditor later obtained notice and filed claims and participated in the distribution.[13]

Bankruptcy Courts Deviated from *Birkett*

Later, the Fifth Circuit's *Robinson* decision determined that out-of-time amendments to schedules would be allowed, but only if exceptional circumstances and equity so required.[14] After *Robinson*, more equitable rulings were entered, and eventually congressional review was demanded. In 1977, Congress reformed and rewrote § 17(a)(3) of the Bankruptcy Act to become § 523(a)(3) of the Bankruptcy Code, which was intended to address the *Birkett-Robinson* conflict. The effort was valiant, but not always embraced. As one court wrote, "Though the words in section 523(a)(3)(A) are rational, they are not unambiguous."[15] Legislative history has provided limited additional guidance.[16]

Since the enactment of § 523(a)(3), more equitable reasons to allow discharge arose. Courts started to deviate from *Birkett* or expand upon *Robinson* with equitable reviews or "tests." If the failure to schedule a creditor is derived solely because of negligence or inadvertence, equity would allow discharge of the debt.[17]

A stricter approach was occasionally applied, and courts reopened cases under 11 U.S.C. § 105 to allow the unscheduled creditor an opportunity to be heard.[18] Some courts assert that a motion to reopen under 11 U.S.C. § 350 requires the court's equitable powers.[19] These equitable powers often refer to a "balancing test," a concept that came from the Supreme Court's multi-part analysis: "[T]he danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith."[20] Using this approach, some courts conclude that § 523(a)(3) is a congressional overruling of *Birkett*.[21]

Courts Allowing the Discharge for the Creditor

Other courts remind the unscheduled creditor of the burden of proof that it is required to meet in order to prevail in seeking exception to the discharge: A § 523(a)(3) claim demands proof that the creditor holds a § 523(a)(2)(4) or (6) claim.[22] In addition, other courts open up their calendars to declaratory actions to determine whether the unscheduled debt is that which is identified under § 523(a)(2)(4) or (6).[23] In such actions, if the debt is not determined to be a § 523(a)(2)(4) or (6) debt, application of § 523(a)(3) does not arise.

The § 726(a)(2)(C) Analysis

Within the Bankruptcy Code are levers that create parity on occasions where underlying factual matters demand the same. Section 726(a)(2)(C) is such a provision. Section 726(a)(2)(C), specifically referenced by the "distribution approach" courts, reads as follows:

> Distribution of property of the estate
>
> (a) Except as provided in section 510 of this title, property of the estate shall be distributed —
>
> ...
>
> (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is —
>
> ...
>
> (C) tardily filed under section 501(a) of this title, if —
>
> (i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and
>
> (ii) proof of such claim is filed in time to permit payment of such claim.

11 *Birkett v. Columbia Bank*, 195 U.S. 345, 25 S. Ct. 38, 49 L. Ed. 231 (1904). The Court ruled that a debtor's neglect or inadvertence is irrelevant and cannot preclude the discharge of unscheduled debt. *Id.* at 351, 25 S. Ct. at 40.

12 Section 17(a)(3), Bankruptcy Act, codified at 11 U.S.C. § 35(a)(3) (repealed by the Bankruptcy Reform Act of 1978).

13 *Milando v. Perrone*, 157 F.2d 1002, 1004 (2d Cir. 1946).

14 *Robinson v. Mann*, 339 F.2d 547, 550 (5th Cir. 1964).

15 *Stone v. Caplan (In re Stone)*, 10 F.3d 285, 289 (5th Cir. 1994): "With so many possible interpretations of the provision in question, one thing seems altogether clear: The words of the section 523(a)(3)(A) are anything but clear and unambiguous." *Id.* at 290.

16 Under § 523(a)(3), a "debt is excepted from discharge *if* it was *not scheduled in time to permit timely action by the creditor to protect his rights*." S. Rep. No. 989, 95th Cong., 2d Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5864 (emphasis added); H.R. Rep. No. 595, 95th Cong., 2d Sess. (1977), 1978 U.S.S.C.A.N. 5963, 6320 (emphasis added).

17 *Stone v. Caplan (In re Stone)*, 10 F.3d 285, 291 (5th Cir. 1994).

18 *In re Walker*, 195 B.R. 187, 208 (Bankr. D.N.H. 1996).

19 *In re Muhammed*, 536 B.R. 351, 355 (Bankr. E.D.N.Y. 2015).

20 *Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 395, 113 S. Ct. 1489, 1498 (1993).

21 *Eglin Fed. Credit Union v. Horlacher (In re Horlacher)*, 389 B.R. 257, 2009 WL 903620, *9 (N.D. Fla. 2009).

22 *In re Lochrie*, 78 B.R. 257, 259-60 (B.A.P. 9th Cir. 1987) ("[A] Creditor must prove its cause of action under § 523(a)(2), (4), or (6), in order to prevail under § 523(a)(3).").

The U.S. Bankruptcy Court for the Middle District of Florida has concluded that § 726(a)(2)(C) "provides that a late-filed claim is treated as though it was timely filed ... and the claim is filed in time for it to be paid."[24] Under the distribution approach, "courts ... take a holistic view and hold [that] ... § 523(a)(3) must be read in conjunction with § 726(a)(2)(C)," and that "§ 523(a)(3) is only concerned with the ability to file a proof of claim."[25] Because § 726(a)(2)(C) allows the late-filed claim parity with the timely filed claims, these courts conclude that the unscheduled creditor is adequately protected.

Opposite Conclusion: Clear Language Must Be Followed

The Supreme Court has made it widely known that the clear language of the Bankruptcy Code must be followed.[26] Bankruptcy courts usually comply,[27] but many courts have found the language of § 523(a)(3) to be ambiguous.

In courts where the language of § 523(a)(3) is deemed unambiguous, "the sole function of the courts is to enforce [the statute] according to its terms." From this perspective, courts agree "with the reasoning in *Laczko* that Section 523(a)(3) is never triggered when no bar date is set; but, in cases in which a bar date is set, the plain language of Section 523(a)(3) controls."[28] This minority interprets the statute to be "unambiguous" and follows the hard-and-fast discharge exception derived from *Birkett*, but only when there is a claims bar date.

Conclusion

Critics have found that Congress failed in its attempt to cure the *Birkett-Robinson* conflict with § 523(a)(3). The language, the majority asserts, is ambiguous. In turn, courts apply equitable approaches to address § 523(a)(3)'s ambiguous terms. In contrast, the minority claims that the language is unambiguous and delivers a strict imposition of discharge denial in asset cases. Until someone delivers the "unambiguous" language argument to the Supreme Court, this conflict shall continue with differences of opinion about the clarity of § 523(a)(3)'s language. To aid the reader, the chart on p. 63 outlines the courts' various interpretations. abi

23 *In re Guseck*, 310 B.R. 400, 404 (Bankr. E.D. Wis. 2004) ("[I]t would be appropriate for the debtor or creditor to move to reopen a bankruptcy case to file a declaratory judgment.").

24 *Creative Enters. HK v. Simmons (In re Simmons)*, Nos. 3:18-bk-03267-JAF, 3:20-ap-0081-JAF, 2021 Bankr. LEXIS 2302, at *4 (Bankr. M.D. Fla. Aug. 24, 2021).

25 *Leadbetter v. Snyder (In re Snyder)*, 544 B.R. 905, 909 (Bankr. M.D. Fla 2016) (citations omitted).

26 *Caminetti v. United States*, 242 U.S. 470, 485 (1917), as cited in *United States v. Ron Pair Enters.*, 489 U.S. 235, 241, 109 S. Ct. 1026, 1030 (1989).

27 *In re Kelly*, 841 F.2d 908, 913 n.4 (9th Cir. 1988) ("Bankruptcy judges have no more power than any others to ignore the plain language of a statute.").

28 *Purcell v. Khan (In re Purcell)*, 362 B.R. 465, 475 (Bankr. E.D. Cal. 2007).