PERILS OF THE OMITTED SPOUSE

By
The Honorable Jim D. Pappas
Chief United States Bankruptcy Judge
District of Idaho

Recently, a state court judge shared a fascinating story arising from an action brought before him by a party seeking to enforce a divorce decree against her former spouse. In the 1995 decree, the man had agreed to pay the parties' joint debts. He did not. Instead, he filed a Chapter 7 bankruptcy petition, and was now asserting his discharge as a defense to his former spouse's action. For reasons that are unclear, he did not schedule his former spouse as a creditor, and she did not learn of the bankruptcy case until after it had been closed by the Bankruptcy Court. The bankruptcy case had been a "no asset" case, in that no property was available to liquidate to pay creditors. Because of this, the Bankruptcy Court had notified creditors not to file claims. This is sometimes called a "no bar-date case".

In response to the argument that her claims against the man had been discharged in bankruptcy, the woman's attorney asserted that her claim should be deemed excepted from discharge under 1994 amendments to the Bankruptcy Code which added Section 523(a)(15). This amendment excepts non-support debts of former spouses arising from a divorce under certain conditions. However, the state court correctly concluded it did not have jurisdiction to make such a finding, since Congress, also in 1994, required that Section 523(a)(15) determinations be made only by the Bankruptcy Court. *See* 11 U.S.C. § 523(c) (1). While the state court considered sending the woman to Bankruptcy Court to reopen the bankruptcy case to obtain a dischargeability determination, the judge astutely observed that the woman's action was time-barred, since F.R.B.P. 4007(d) requires such an adversary proceeding be commenced within 60 days following the creditor's meeting.

The state judge recognized that the woman's best chance to avoid her former spouse's discharge was based on Section 523(a)(3), the "omitted creditor" exception. This is a discharge exception which the state courts have concurrent jurisdiction to apply. Analyzing that statute under these facts, however, revealed a curious, even frustrating, result.

Under Section 523(a)(3)(A), if a creditor is neither listed in a debtor's bankruptcy schedules, nor acquires actual knowledge of the bankruptcy case, in order to timely file a proof of claim, the creditor's claim is excepted from discharge. This provision applies to all debts other than those excepted from discharge under Sections 523(a)(2), (4) or (6), the fraud and willful tort provisions. However, an "exception to the exception" has developed in the case law construing this provision. If the bankruptcy case in question was a no asset, no bar-date case, where no deadline for filing proofs of claim is set by the Bankruptcy Court, this exception to discharge will not apply. That is, if there is no distribution to creditors, the creditors are not prejudiced by having their claims deemed discharged, even if they did not know about the bankruptcy case.

For instance, *In re Beezley*, 994 F.2d 1433 (9th Cir. 1992), dealt with a Chapter 7 debtor who, after receiving his discharge, attempted to amend his schedules to include an unlisted debt with the notion that doing so would discharge the debt. However, since the proceeding was a no asset case, no bar-date had been set by which creditors would be required to file a proof of claim and thus Section 523(a)(3)(A) did not apply. The Court concluded that in the typical no asset, no bar-date case, a debtor's failure to list a creditor leaves the creditor's claim discharged unless otherwise affected by Section 523.

Under Section 523(a)(3)(B), additional protection is provided omitted creditors holding claims that could have been excepted from discharge under Sections 523(a)(2), (4), or (6). If such a creditor does not learn of the debtor's bankruptcy case in time to request a determination of dischargeability under the F.R.C.P. 4007(d) deadline discussed above, its claim is excepted from discharge on that basis alone. Obviously, this subsection was intended by Congress to protect creditors holding claims which only the Bankruptcy Court can determine excepted from discharge from missing the deadline for commencing an adversary proceeding because they have no notice of the bankruptcy case.

The Section 523(a)(3) rules seem to make sense. But what about the woman in the state court case? Sadly, it seems that Congress has created a trap for the unwary former spouse. When it amended the Code to add Section 523(a)(15), and in Section 523(c) to vest exclusive jurisdiction in the Bankruptcy Courts to make (a)(15) determinations, Congress should also have granted omitted (a)(15) claimants the protections found in Section 523(a)(3)(B). *Collier on Bankruptcy, Vol. 4, ¶ 523.09[1]*, calls the failure of Congress to amend Section 523(a)(3)(A) and (B) when Section 523(c)(1) was amended in 1994 an inadvertent omission, and suggests that (a)(15) should possibly be considered included under Section 523(a)(3). While this may be true, case law suggests supplying omissions, even when such an omission is inadvertent, goes beyond the bounds of the judicial function. *West Virginia University Hospitals v. Casey*, 499 U.S. 83, 101, 111 S.Ct. 1138, 1148, 113 L.Ed.2d 68 (1991) (quoting *Iselin v. United States*, 270 U.S. 245, 250-251, 46 S.Ct. 248, 250, 70 L.Ed. 566 (1926)).

Since the woman in state court does not hold a claim excepted from discharge under Section 523(a)(2), (4) or (6), the fact that she had no notice or knowledge of her former spouse's bankruptcy case did not save her from Rule 4007(c)'s 60-day deadline for requesting a discharge determination. Moreover, because the Debtor's case was a no asset, no bar-date case, Section 523(a)(3)(A) would also not apply under the *Beezley* rationale.

True enough, the creditor in this situation may want to consider reopening the bankruptcy case to seek a revocation of the debtor's discharge under Section 727(d)(1) by arguing that her former spouse obtained a discharge by fraud. This solution is also fraught with problems. First, the creditor must be able to prove that the debtor's failure to schedule her claim was knowingly and fraudulently done with the intent of depriving her of notice. His mere inadvertence in omitting her claim would not be enough. Moreover, the creditor is faced with another deadline that may have passed, since a request to revoke a discharge must be made within one year after entry of the discharge.

So what's the moral of the story? Family lawyers beware! Pending further amendments to the Bankruptcy Code, vigilance is the divorce creditor's best defense, lest a quiet bankruptcy filing intervene.