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Discharge, Disclosure and Due Process: Bankruptcy's Bargain

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Although bankruptcy courts are not Article III courts that can exercise the full judicial power of the U.S., the concept of constitutional due process still guarantees a day in court to parties-in-interest whose rights might be affected by the bankruptcy process.[1] It has long been recognized that "the fundamental purpose of notice to creditors is to give to each an equal opportunity with other creditors to avail himself of the benefits of the law."[2] Creditors are most affected by the discharge, freeing debtors from personal liability on their dischargeable pre-petition debts. The Bankruptcy Code affords debtors this relief and others in exchange for their obligations of disclosure to the bankruptcy court, and notice to their creditors and other parties-in-interest.[3]

While the discharge is a powerful tool, it is not without limits. The discharge for individual debtors is expressly limited by § 523(a)(3),[4] which directly incorporates the concept of notice and disclosure to ensure that parties-in-interest receive due process. Specifically, § 523(a)(3) excepts from discharge any debts that are owed to creditors that the debtor fails to duly list in the creditor matrix and relevant schedules where such creditor was prevented from timely filing a proof of claim and had no notice or actual knowledge of the bankruptcy case.[5] This article encourages early and accurate disclosure of creditors with the court so the debtor obtains the Code's intended relief.

Notice Requires Adequate Disclosures

Notice starts with and depends on the debtor holding up his/her end of bankruptcy's bargain: disclosure. Section 521 of the Bankruptcy Code governs the debtor's disclosure obligations following the petition filing. Among other things, it requires debtors to file a list of creditors, schedules of the debtor's liabilities and various statements indicating the debtor's intent to either retain or surrender property subject to security interests or liens.[6] Rule 1007 of the Federal Rules of Bankruptcy Procedure is the procedural corollary to § 521. It requires debtors in voluntary cases to file with their petition a list of the names and addresses of entities that are — or will be — included in their various schedules of creditors, executory contract counterparties and co-debtors.[7] This list is colloquially known as the "creditor matrix," and the entities listed therein at and around the time of the petition date are the entities that receive notice of the commencement of the bankruptcy case.

Notice

Section 342(a) of the Bankruptcy Code reaffirms the fundamental guarantee of due process for creditors by requiring that "[t]here shall be given notice as is appropriate ... of an order for relief" under the Code.[8] Generally, the clerk of the court, relying on accurate disclosures by the debtor (and by proxy, debtor's counsel), is responsible for notifying parties-in-interest of the filing of a bankruptcy case.

When a bankruptcy case is commenced by filing with the clerk of the bankruptcy court a petition[9] (the "order for relief" in a voluntary case),[10] the clerk in turn must "forthwith transmit to the [U.S. Trustee] a copy of the petition."[11] In addition, unless the court has directed otherwise,[12] Rule 2002(f) of the Federal Rules of Bankruptcy Procedure requires the clerk to provide *all* creditors notice of the order for relief.[13]

The creditor matrix is generally the "only information about the identities and addresses of creditors" available to the clerk for noticing purposes, and that information must come, at least initially, from the debtor.[14] Relying on the debtor's creditor matrix and the names and mailing addresses contained therein, the clerk utilizes Official Form 309 (the "notice of bankruptcy") to send out notice of the case to parties-in-interest.

1 *Licup v. Jefferson Ave. Temecula LLC (In re Licup)*, 95 F.4th 1234, 1238 (9th Cir. 2024) (citing *In re Fauchier*, 71 B.R. 212, 215 (B.A.P. 9th Cir. 1987)); U.S. Const. amend. V.
2 *In re DeSoto Crude Oil Purchasing Corp.*, 35 F. Supp. 1, 7 (W.D. La. 1940) (discussing due process in context of Bankruptcy Act of 1898); *see also In re Mancini*, No. 85-30168, 1986 WL 28905, at *6 (Bankr. S.D.N.Y. March 26, 1986).
3 *In re Anderson*, 641 B.R. 1, 43 (Bankr. S.D.N.Y. 2022) (citing *Mooney v. Green Tree Serv. LLC (In re Mooney)*, 340 B.R. 351, 362 n.29 (Bankr. E.D. Tex. 2006)) (observing that discharge relieves pressure to pay in exchange for debtor subjecting themselves to rigors of bankruptcy process).
4 11 U.S.C. § 523(a) (providing exceptions to discharge for individual debtors under §§ 727, 1141, 1192, 1228(a), 1228(b) and 1328(b)); 11 U.S.C. § 1328(a)(2) (excepting from chapter 13 "super discharge" debts "of the kind specified in" § 523(a)(3)).
5 11 U.S.C. § 523(a)(3).
6 11 U.S.C. § 521(a).
7 Fed. R. Bankr. P. 1007(a)(1).
8 11 U.S.C. § 342(a).
9 11 U.S.C. § 301(a); Fed. R. Bankr. P. 1002(a).
10 11 U.S.C. § 301(b).
11 Fed. R. Bankr. P. 1002(b).
12 It is most common that the clerk of court serves this function. In some jurisdictions, this duty might be delegated by the bankruptcy court to another entity. For example, the chapter 13 trustee might perform this duty in chapter 13 cases. For simplicity, this article will discuss this noticing as an obligation of the clerk of court.
13 Fed. R. Bankr. P. 2002(f)(1).
14 *In re Hicks*, 184 B.R. 954, 957 (Bankr. C.D. Cal. 1995).

On top of providing knowledge that a bankruptcy case has been filed, the notice of bankruptcy informs creditors of other significant dates and deadlines. Among other details, the clerk provides notice of (1) the claims bar date, (2) the deadline to file a complaint objecting to the discharge under § 727, and (3) the deadline for filing a complaint to determine the dischargeability of a debt pursuant to § 523(c).[15] Accordingly, it is of the utmost importance that this information is timely provided to creditors.

Failure Has Consequences

Insufficient notice to creditors of the dates and deadlines in the notice of bankruptcy has potentially severe consequences. For example, if a creditor is not provided timely notice of the date of the § 341 meeting, a creditor may seek court approval to examine the debtor pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. A creditor without *timely* notice of a claims bar date may move for an extension of time to file a proof of claim,[16] potentially disrupting the calculations under a proposed plan or upsetting a trustee on the edge of disbursements. As previously noted and possibly most upsetting to your client, the failure to timely provide notice of the time to file a proof of claim or the deadline to file a complaint to determine the dischargeability of certain debts implicates § 523(a)(3).

We know that creditors whose debts are scheduled and listed pursuant to § 521(a) at or around the petition date receive notice of the commencement of the bankruptcy case from the clerk, and as long as those debts are not otherwise nondischargeable under § 523, those debts are discharged. In other words, the trade-off is complete: The debtor (with the clerk's aid) meets its obligation of disclosure and notice, affording due process to the affected creditors, and those debts are then discharged. What happens when a creditor is not included on the matrix, or if the address listed for the creditor is incorrect and thus notice never reaches the creditor? Is the bankruptcy bargain broken? *Licup v. Jefferson Avenue Temecula LLC* from the Court of Appeals for the Ninth Circuit exemplifies the ramifications.[17]

Licup

An individual "asset" chapter 7 case, *Licup* addressed a dischargeability dispute with respect to a pre-petition default judgment entered against the debtor in an unlawful-detainer suit.[18] The judgment included a monetary award to the creditor of $31,780.29.[19] When the debtor later filed for chapter 7 relief, she filed her schedules and creditor matrix with the bankruptcy court, including the debt owed to her judgment creditor, but she listed an incorrect mailing address for the judgment creditor's attorney.[20] Thereafter, the debtor received a discharge and the case was closed.[21]

Nearly five years after the discharge, the judgment creditor initiated an adversary proceeding seeking a determination that the judgment debt of $31,780.29 was excepted from the discharge pursuant to § 523(a)(3) because the creditor did not receive notice of the bankruptcy filing.[22] The debtor then argued that the amount excepted from discharge should be limited to $1,614.74, the portion of the debt that would have been paid had proper notice been provided and a proof of claim been filed.[23]

The bankruptcy court held that the entire debt was nondischargeable under § 523(a)(3) because the creditor did not receive notice of the bankruptcy.[24] On appeal, the bankruptcy appellate panel affirmed for the same reason.[25] At the Ninth Circuit Court of Appeals, the debtor (citing circuit precedent) argued that in no-asset cases where creditors are not required to file claims, debts such as the judgment debt at issue would be discharged, and therefore, according to the debtor, the judgment debt should likewise be discharged regardless of the notice issue.[26]

The court of appeals disagreed, noting that the obligation to list debts under Bankruptcy Rule 1007 and § 521(a) requires the debtor to state the creditor's name and correct address.[27] The court of appeals observed that the obligation is rooted in principles of due process, and that the debtor's failure to meet that obligation deprives the creditor of their day in court.[28]

The Ninth Circuit distinguished the case at bar where there *were* assets to liquidate and pay creditors from no-asset cases where creditors are not required to file claims, and the protections afforded to creditors under § 523(a)(3) are irrelevant because filing a claim in such cases would be meaningless.[29] The court of appeals also held that the Bankruptcy Code's plain language did not contain a partial-discharge provision under § 523(a)(3). Therefore, the court would not read one in, even to prevent — as the debtor described it — a windfall to the judgment creditor.[30] As a result, the court of appeals affirmed.

Licup is an important lesson for debtor attorneys about protecting the individual debtor's discharge: Meet the obligations of notice, disclosure and due process, or risk your client's fresh start. To that end, ensuring that creditors are properly notified of the bankruptcy and thoroughly reviewing the debtor's disclosures — even after the initial notice of bankruptcy has gone out to the creditors on the mailing matrix — should be top of mind for debtors and their counsel.

Help Us Help You (and Your Client)

Prompt and proper "notice reasonably designed to bring the matter in ordinary course to the creditor's attention"[31] is a standard that certainly has its benefits, particularly when the

15 Fed. R. Bankr. P. 2002(f)(3)-(5).
16 Fed. R. Bankr. P. 3002(c)(6).
17 *In re Licup*, 95 F.4th 1234 (9th Cir. 2024).
18 *Id.* at 1236.
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.*
23 *Id.*
24 *Id.* at 1237.
25 *Id.*
26 *Id.* at 1238 (citing *In re Nielsen*, 383 F.3d 922 (9th Cir. 2004)).
27 *Id.*
28 *Id.*
29 *Id.* (citing Fed. R. Bankr. P. 2002(e), 3002(a)).
30 *Id.*
31 *In re Torres*, 15 B.R. 794, 796 (Bankr. E.D.N.Y. 1981) (citing *N. Am. Car Corp. v. Peerless Weighing & Vending Mach. Corp.*, 143 F.2d 938, 941 (2d Cir. 1944)).

continued on page 52

from page 31

clerk is providing the notice! Allowing the clerk to provide notice and to certify that such notice was given is excellent evidence that the creditor was timely made aware of the case and associated dates and deadlines. "While there has long been recognized a presumption that properly mailed articles are received by the addressee," a debtor asserting proper service must prove proper mailing.[32]

Debtors (or debtors' counsel's staff) need not be questioned on this front if the clerk was responsible for service. The clerk's certification provides the necessary evidence to trigger the presumption. The burden then becomes the creditor's hurdle — and a mere "denial of receipt is insufficient to rebut a presumption that proper notice was given."[33] Accurate initial disclosure made early can also save money and make that filing fee worth it! When the clerk is responsible for noticing, the cost is on the judiciary.[34]

However, if amendments are necessary, the noticing workload is the debtor's to bear. The inclusion of an incorrect address for a creditor or failure to include a particular creditor on the original creditor matrix requires amendment of the schedules and the matrix. Certainly, amendments are not uncommon. Rule 1009(a) of the Federal Rules of Bankruptcy Procedure expressly contemplates voluntary amendments to the debtor's schedules, statements and lists,[35] but such amendments require the debtor to give notice to any entity affected by the amendment.[36]

As distinguished from the clerk's duties in the beginning of the case, neither § 342(a) nor Bankruptcy Rule 2002(f) requires the clerk to send out notices of amended lists and schedules. What is more, notice of the amendment might not be the only item that the debtor is responsible for sending out. Local rules or procedures in many jurisdictions require the debtor (or debtor's counsel) to send out the notice of bankruptcy to those creditors and certify that such noticing has been completed.[37]

Conclusion

An individual debtor's discharge is the quintessential component of the debtor's fresh start. Thus, it should be the debtor and debtor's counsel's prime objective to protect it by meeting the debtor's obligation to provide creditors with due process through disclosure and notice. Careful attention to initial disclosures at the beginning of the case can save debtors money and avoid the need for the debtor, rather than the clerk, to shoulder the workload of providing certain notices.

Even if initial disclosures contain errors or creditors are missed, exercise of diligence by double-checking those disclosures — even after the notice of bankruptcy has been transmitted — is worth the effort to protect the debtor's fresh start. Bankruptcy's trade-off for the individual debtor requires complete disclosure and notice to the court and creditors in exchange for the debtor's freedom from pre-petition debts. Given the stakes, debtors and their counsel should take care to uphold the debtor's end of bankruptcy's bargain. abi

32 *In re Smith*, 42 B.R. 927, 931 (Bankr. D. Mass. 1984).
33 *Davis v. Brown*, 86 F.3d 1146 (1st Cir. 1996).
34 Most courts contract with an outside company, the Bankruptcy Noticing Center, to produce and mail certain notices, including the notice of bankruptcy.
35 Fed. R. Bankr. P. 1009(a).
36 *Id.*
37 *See, e.g.*, Bankr. E.D. Va. L.R. 1009-1(B); Bankr. W.D. Va. L.R. 1009-1(B), (C).

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