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WITH SPECIAL THANKS TO ROBERT A. DUBIN, ESQ., ERICA J. EHRLICH, ESQ., AND ELLEN FABA FOR THEIR INVALUABLE ASSISTANCE IN PREPARATION.

"It may not be as it appears" – Unlisted debts not discharged in bankruptcy.

Divorce is a complex proceeding, often dealing with issues concerning the division of assets, custody of children, spousal and child support, and the division of debts. One would think the process would become less complex if certain issues, such as debts, were resolved prior to the filing for divorce. Eliminating the parties' debts through bankruptcy prior to filing for divorce might lead a family law lawyer to think "*That's one less issue we have to deal with.*" In many instances, that would probably be true. However, given the recent holding in *First Place Bank v. Tate*, et al, 2013 WL 331572 (Mich.App. 2013)("*First Place Bank*"), a family law lawyer now must dig deeper to determine if a debt has truly been discharged in bankruptcy.

Factual Background of *First Place Bank v. Tate*

In January, 2010, Terri A. Tate ("Tate") filed a Chapter 7 Bankruptcy.[1] In her bankruptcy schedules, Tate listed numerous debts including business loans, personal credit cards, medical expenses, and utility bills. However, Tate failed to list First Place Bank ("Bank") as a creditor in her bankruptcy. On October 26, 2010, Tate received from the bankruptcy court her discharge pursuant to 11 U.S.C. 727.

On February 18, 2011, less than 4 months after she received her discharge, Tate was sued by the Bank in the Oakland County Circuit Court.[2] After several months of discovery, the case proceeded to hearing on the Bank's Motion for Summary Disposition. Following a hearing on the motion, the circuit court entered a judgment against Tate in the amount of $415,135.14. Tate appealed.

In an unpublished opinion,[3] the Michigan Court of Appeals in *First Place Bank* affirmed the circuit court's entry of the judgment against Tate despite her prior discharge from the bankruptcy court. In doing so, the Court of Appeals relied on the exceptions to discharge as set forth in 11 USC §523(a)(3)(A). In part, 11 USC §523(a)(3)(A) provides:

> **(a)** A discharge under section 727, 1141, 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.

On appeal, Tate did not dispute that she failed to list Bank on her bankruptcy schedules. Neither did Tate dispute that Bank had no knowledge of her bankruptcy case before her case was closed. Rather, Tate argued on appeal that since her bankruptcy was a "no-asset case," the debt owed to Bank was discharged despite §523(a)(3)(A). Tate believed that since there were no assets for the trustee to distribute

to creditors, Bank would have been in the same position (and received nothing) had timely notice of the bankruptcy proceeding been given. Therefore, Tate claimed the debt was discharged despite Bank's lack of notice of the bankruptcy.

The Court of Appeals disagreed with Tate holding that the language of §523(a)(3)(A) is clear that the unlisted and unscheduled debt to Bank was excepted from discharge. In part, the Court of Appeals reasoned that "*It is well established in Michigan law that '[n]othing may be read into a clear statute that is not within the manifest intent of the Legislature as derived from the statute itself.'*"[4] The Court of Appeals found Tate's failure to list Bank as a creditor in her bankruptcy schedules as a basis under §523(a)(3)(A) for which the debt to Bank was non-dischargeable.

Concerns for the Family Law Lawyer

When determining how to conclude a divorce, lawyers and clients often weigh "*who is responsible for what marital debt*" versus "*who gets what.*" Today, they must now be more mindful of the effect and limitations of client's prior bankruptcy discharge given the holding in *First Place Bank*. Debts once believed to be "expunged" may not be. Consideration must be given to unknown debts that may still be lurking.

Commonly, a Judgment of Divorce provides that the parties share responsibility for contingent, unliquidated debts such as a tax liability or a deficiency on a mortgage. To allocate the responsibilities, language should be placed into the Judgment of Divorce that addresses the parties' responsibilities for the debts. But what about the marital debts the parties may have forgotten to list in their bankruptcy schedules?

First. The use of due diligence to ascertain the parties' debts is a must. Clients should be encouraged (and counsel should demand) that a client obtain his or her credit reports from the major credit reporting agencies. Counsel should also require a client to provide a copy of their bankruptcy schedules to ascertain which debts have been identified and discharged.

Second. A family law lawyer should assume a client's recollection of all debts is not absolute. Assuming that parties do not recall all of their debts will cause a lawyer to deal with the unknown. When offering or accepting a settlement, or preparing a Judgment of Divorce, consider the use of language that assigns responsibility for debts that the parties may have forgotten.

Finally. If your client is considering filing for bankruptcy, make sure that he or she seeks the assistance of a lawyer who specializes in consumer bankruptcy. The proper preparation of bankruptcy schedules and the requisite due diligence should provide the best protection for a client against future claims by creditors.

The Court of Appeals in *First Place Bank* went out of its way to make sure Tate paid the price for what appeared to be a deliberate refusal to list a creditor. That may be the reason why the *First Place Bank* opinion was unpublished. Other bankruptcy courts have opined to the contrary, holding that there is "no harm/no foul" in a "no-asset case" where a debtor inadvertently omits a creditor from their bankruptcy schedules.[5] In those cases, the unlisted debts were held to have been discharged despite the failure to list a creditor.

In the event of a situation like that which Tate experienced, your client should consult with a bankruptcy expert. The outcome may have been much different for Tate had her issue been handled by a bankruptcy judge rather than in state court.

Endnotes

1. United States Bankruptcy Court, Eastern District of Michigan, Southern Division - Case No. 10-42395-pjs.
2. Oakland County Circuit Court Case No. 2011-117075-CK.
3. MCR 7.215(C)(1) provides that "[a]n unpublished opinion is not precedentially binding under the rule of stare decisis. A party who cites an unpublished opinion must provide a copy of the opinion to the court and to the opposing parties with the brief or other paper in which the citation appears."
4. *Id*. at 4. Citing *Sietsema Farms Feeds, LLC v. Dep't of Treasury*, 296 Mich App 232, 237; 818 NW2d 489 (2012).
5. *In re Madaj*, 2149 F3rd 467 (CA 6, 1988); *In re Stark*, 717 F.2d 322 (CA 7, 1983).