CONSUMER BANKRUPTCY

The Omitted Creditor in a Closed Bankruptcy Case

Recent decision analyzes current split between circuits

By Craig D. Robins

Here's a perplexing situation that all of us bankruptcy attorneys find ourselves in from time to time. Weeks, months or years after a bankruptcy case is closed, a client calls up to say that a debt was inadvertently omitted from the filing. What do you do?

This has been a conundrum for years. Attorneys seem to have great difficulty tackling this and deciding what the appropriate course of action is. Do you re-open the case to amend the schedules to add the omitted creditor? Or do you send a letter to the creditor saying the debt was discharged even though it was never scheduled? There is good reason for the confusion. Both are correct answers, but depending on the jurisdiction.

The difficulty for us here in New York is that the Second Circuit, unlike most other circuits, has yet to rule on this issue. As there is a split between the circuits, some courts have ruled that a debtor must amend the schedules whereas others have held the opposite, that the debt is discharged if it is a no-asset case, even if it was never scheduled in the first place. There is even a split amongst the Second Circuit courts.

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This column, in June 2009, was devoted to this issue and highlighted *a* decision issued by the late Judge Dennis E. Milton in Brooklyn, *In re Coppola*, (U.S.B.C. E.D.N.Y., Case No. 96-21661-dem, April 20, 2009).

In that case, Judge Milton discussed the two approaches. Under the "mechanical approach," courts have denied motions to reopen no-asset cases, finding that the debt owed to an omitted creditor is discharged "as a matter of law." Under this approach, there is no reason to reopen a bankruptcy case, provided that it is a no-asset case and the debt is not otherwise excepted from discharge.

Under the "equitable approach," courts consider whether the debtor's omission was the result of fraud, recklessness or intentional design, or if it would prejudice the creditor's rights. Good faith is an important element. Courts adopting this approach have held that motions to reopen no-asset cases to list omitted creditors should be liberally granted to afford omitted creditors an opportunity to file a non-dischargeability complaint.

Unfortunately, although that decision contained a good discussion of these two approaches, it still left undetermined what the appropriate protocol is in this district.

However, we finally have some guidance in the form of a fresh, new written decision from Judge Alan S. Trust, sitting in the Central Islip Bankruptcy Court, who has analyzed the issue and given us direction on handling it, at least until the issue reaches a higher court.

Judge Trust followed the mechanical approach and adopted a test that should be applied in these circumstances: a Chapter 7 no-asset case should not be re-opened to allow an undisclosed debt to be scheduled unless: (i) the debtor or creditor can state a plausible basis for seeking a determination that the debt at issue does or does not fall within the category of non-dischargeable debts listed in Sections 523(a)(2), (4) or (6); or (ii) the creditor can state a plausible basis for the court to determine that assets may become available to distribute to creditors; or (iii) prejudice to either party, which can be remedied by reopening the case, has been demonstrated. *In re: Mohammed*, (Bankr. E.D.N.Y., Case No. 13-73191-ast, September 4, 2015).

In *Mohammed*, Judge Trust denied the debtor's application to re-open the case to add the creditor. He determined that the central issues were whether an unscheduled debt is automatically discharged in a no-asset Chapter 7 case, and if so, whether a closed case should be re-opened to schedule it.

In that case, the debtor defaulted in a

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state court collection action in which the debtor was one of three defendants. The state court entered a $430,000 default judgment against her. A little over a year later, she filed for Chapter 7 relief, listing 35 creditors holding $600,000 in claims, but she did not list the judgment in her schedules or the lawsuit in the Statement of Financial Affairs.

Actually, the debtor neglected to disclose the existence of the judgment or lawsuit to the court or the trustee at any point during the case. Judge Trust commented that the debtor's excuse for not scheduling the debt (she claimed she wasn't aware) was not completely satisfactory, and she should have disclosed this information. Nevertheless, he held that the unscheduled debt was discharged, and for that reason, there was no need to re-open the case.

In analyzing the great number of cases dealing with this issue, and recognizing the considerable divided case law which has long been the subject of academic debate, Judge Trust expressed his opinion that the mechanical approach is more consistent with the language of the Bankruptcy Code and that the court need not apply an equitable balancing test.

Practical tip. The advice given in this column in 2009 still stands. For most garden variety situations where the debtor omits a typical credit card debt and advises the attorney within a few years, the courts here will likely follow *Mohammed* and be unwilling to permit counsel to reopen the case to add the creditor, asserting that, under the mechanical approach, the debt is dischargeable. In such cases, counsel should instead consider sending a certified letter to the creditor stating that the debt has been discharged, together with copies of the notice of commencement and order of discharge and perhaps a copy of the *Mohammed* decision or this column.

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