

Adversary Proceedings

Basics

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Fundamentals

What is an Adversary Proceeding: An “adversary proceeding” is a lawsuit within the bankruptcy case and the rules governing such proceedings closely parallel the Federal Rules of Civil Procedure, requiring the proceeding to be commenced by a complaint, providing federal civil discovery procedure, and the like.

Bankruptcy Rule 7001 specifies those types of proceedings that must be brought as adversary proceedings:

- (1) a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee, or a proceeding under § 554(b) or § 725 of the Code, Rule 2017, or Rule 6002;
- (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, but not a proceeding under Rule 3012 or Rule 4003(d);
- (3) a proceeding to obtain approval under § 363(h) for the sale of both the interest of the estate and of a co-owner in property;
- (4) a proceeding to object to or revoke a discharge, other than an objection to discharge under §§ 727(a)(8), (a)(9), or 1328(f);
- (5) a proceeding to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;
- (6) a proceeding to determine the dischargeability of a debt;
- (7) a proceeding to obtain an injunction or other equitable relief, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief;
- (8) a proceeding to subordinate any allowed claim or interest, except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for subordination;
- (9) a proceeding to obtain a declaratory judgment relating to any of the foregoing; or
- (10) a proceeding to determine a claim or cause of action removed under 28 U.S.C. § 1452.

Timing of an Adversary Proceeding: Pursuant to FRBP 4007, creditors have 60 days from the **first scheduled** date of the Meeting of Creditors to file complaints against the debtor(s) under Section 523(c). A creditor can bring an objection to discharge of a debt for willful or malicious injury (see below) at any time prior to discharge under § 1328(a)(4) in a Chapter 13 case, but only

has 30 days to file an objection to dischargeability under § 523(a) (6) in Chapter 13 if the debtor receives a hardship discharge pursuant to § 1328(b)

An untimely objection to discharge is unlikely to succeed, as “absent unique and exceptional circumstances..., we do not inquire into the reasons a party failed to file on time in assessing whether she is entitled to an equitable exception from FRBP 4007(c)’s filing deadline....” *Anwar v. Johnson*, 2013 WL 3306327 (9th Cir. July 2, 2013) and that deadline cannot be retroactively extended. *Willms v. Sanderson*, 723 F.3d 1094 (9th Cir. 2013). Local Rules may allow additional time to commence nondischargeability actions by unlisted creditors. *See, for example*, Eastern District of Michigan Local Bankruptcy Rule 1009-1(d).

Pursuant to Rule 4007(b), a debtor may file a complaint at any time seeking a determination of the dischargeability of any debt and can often re-open a bankruptcy case (perhaps without having to pay a filing fee depending on the jurisdiction and Local Rules) as well.

How to Commence an Adversary Proceeding: Bankruptcy Rules 5005(a) and 7003 require that a complaint commencing an adversary proceeding be filed with the bankruptcy court in which the case under the Code is pending unless 28 U.S.C. § 1473 authorizes the filing of the complaint in another district. The Adversary Proceeding will be linked through PACER to the underlying bankruptcy case (the “Main Case”), but will have a separate case number and docket.

Filing Fees: The filing fee for an Adversary Proceeding is \$350, but there is no filing fee if it is commenced by the trustee or debtor-in-possession (then the fee must be paid only by the estate, to the extent there is an estate), by the debtor as the plaintiff, or by a child support creditor or representative.

Common Elements: Review Local Rules for any additional pleading requirements, but generally a Complaint in an Adversary Proceeding should include:

1. Jurisdiction—28 U.S.C. § 1334(b)
2. Venue—28 U.S.C. § 1409(a)
3. Whether or not it is a “core” proceeding—28 U.S.C. § 157(b)(2)¹
4. The statutory basis for the complaint (*i.e.* discharge under 11 U.S.C § 523(a)(8), “undue hardship,” etc.)
5. The supporting facts—be sure to allege sufficient facts to meet the plausibility standard set forth in *Twombly*, 550 U.S. 544, 557 (2007), and *Iqbal*, 556 U.S. 662, 678 (2009)
6. The prayer for relief

Issuance of the Summons: Check your Local Rules/administrative procedures manual to see if the Clerk or the plaintiff prepares the summons. (It is likely generated automatically through filing the Complaint in CM/ECF.)

¹ *See In re Safety Harbor Resort and Spa*, 456 B.R. 703 (Bankr. M.D. Fla 2011) and *British American Ins. Co., Ltd. v Fullerton, et. al. (In re British American Insurance Company Limited)*, 600 B.R., 890 (Bank. S.D. Fla. 2019) for excellent primers on “core” vs. “non-core” and jurisdiction.

Service: Service of an Adversary Complaint is governed by FRBP 7004. First class mail is generally allowed, but see exceptions for service on “infants and incompetents” under FRBP 7004(b)(2), for governmental entities under 7004 (b)(4), (5) and (6) and for Federally insured depositories under 7004(h). With respect to adversary complaints against the debtor (such as discharge or dischargeability), notwithstanding that the debtor in the main case may be represented by an attorney, the debtor must be served as the attorney is not assumed to represent the debtor in the adversary proceeding unless and until that attorney appears. If the debtor is represented by an attorney in the main case that attorney must be served also. FRBP 7004(g). Because the filing of the adversary complaint becomes a docket entry on the docket in the main case, both debtor’s counsel and any trustee will get notice of the adversary proceeding (though such notice does not constitute service).

Service on any agency or division of the Federal Government, including the U.S. Department of Education for a Student Loan Adversary Proceeding, requires that the Summons and Complaint also be timely served on:

- i. The Civil process clerk, local U.S. attorney’s office;
- ii. The U.S. Attorney General in Washington, D.C.; and
- iii. The head of the agency (*i.e.* the Secretary of the U.S. Department of Education)

Service on domestic and foreign corporations, partnerships or other unincorporated associations must comply with FRBP 7004(b)(3) and, in many cases, 7004(h). Rule 7004(b)(3) requires service of the Summons and Complaint by mail to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant. Whether that needs to specify an individual by name appears to often be a question of local custom and judicial preference.

FRBP Rule 7004(h) (which unlike most other FRBP is statutorily mandated by Congress and cannot be changed by the NBRC) requires service on a federally insured depository institution by certified mail, at its specified address, unless an attorney has appeared on its behalf, it has waived in writing service by certified mail, or the court has ordered otherwise. This includes both Federal Deposit Insurance Corporation (FDIC) insured banks and National Credit Union Administration (NCUA) insured credit unions.

To find out if a party is an FDIC insured bank, you search on FDIC’s website at the following address:

<https://research.fdic.gov/bankfind>

In order to determine if a credit union is insured by the NCUA, search the NCUA website at:

<https://mapping.ncua.gov/ResearchCreditUnion.aspx>

Proof of Service must be filed in the adversary case.

How to get paid for Adversary Proceedings: Obviously the payment of attorneys' fees by a creditor seeking to have a debt declared to be nondischargeable is a private matter between it and its lawyer. An attorney for the trustee must comply with 11 U.S.C. §§ 328 and 330. The attorney for the debtor must also comply with such provisions, but it is worthy of note that 11 U.S.C. 330(a)(4)(B) does not require that the attorney for a debtor in a Chapter 12 or 13 case act for the benefit of the estate, but only for the debtor(s).

Regarding the additional services provided or required for an adversary proceeding, nearly every bankruptcy court allows, whether through local rules, rights and responsibilities agreements, or standing orders, the "unbundling" of adversary proceedings from the fee charged for the underlying bankruptcy. This requires that the contract for representation between the debtor and debtor's counsel in the underlying main case clearly exclude representation in adversary proceedings and, if so, that there be a separate written agreement. This does, however, also allow the debtor and their attorney to pay for those legal services after the filing of the bankruptcy case, without running afoul of concerns over collecting on pre-petition agreements.

Common Types of Adversary Proceedings:

§ 523 Actions by Creditors:

Pre-Litigation Considerations: Even if a claim is determined to be nondischargeable, that doesn't by itself mean that the debtor will pay. Creditors should evaluate what the prospects are for payment, including whether the debtor has the ability to obtain funds to resolve the claim. Nondischargeable does not equate to being a priority claim or immediately (or ever) payable, whether because the debtor will remain in Chapter 13 for another 5 years or because there is no effective means of judgment collection after the Chapter 7 bankruptcy- as all non-exempt assets will have been liquidated and many states have limited or no garnishment.

Types of Nondischargeability Actions: Some common types of nondischargeability actions in Chapter 7 include:

- § 523(a) (2) – false pretenses, false representation, or actual fraud;
- § 523(a) (4) fraud or defalcation;
- § 523(a) (6) willful and malicious injury.

Often, a State Court judgment sounding in fraud will be given preclusive effect and allow a creditor to obtain a nondischargeability judgment in an adversary proceeding by summary judgment.

Elements of Nondischargeable Claims:

1. False Pretenses or Fraud under §523(a)(2):²
for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
 - (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition;
 - (B) use of a statement in writing—³
 - (i) that is materially false;
 - (ii) respecting the debtor’s or an insider’s financial condition;
 - (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
 - (iv) that the debtor caused to be made or published with intent to deceive; or
 - (C)
 - (i) for purposes of subparagraph (A)-
 - (I) consumer debts owed to a single creditor and aggregating more than \$500 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and
 - (II) cash advances aggregating more than \$750 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and
 - (ii) for purposes of this subparagraph—
 - (I) the terms “consumer”, “credit”, and “open end credit plan” have the same meanings as in section 103 of the Truth in Lending Act; and
 - (II) the term “luxury goods or services” does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor;
2. Defalcation under §523(a)(4):
 - for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny

² Note that in 2023, the U.S. Supreme Court decided in *Bartenwerfer v. Buckley*, 598 U.S. 69 (2023) that an innocent business partner cannot discharge a debt arising from a state court judgment based on imputed liability for fraud committed by a partner.

³ Note that small omissions are usually insufficient to meet this materiality test. Similarly, a false statement that is irrelevant to the decision about whether to grant credit is not material. Usually, the creditor is relying on the debtor’s credit history. Thus, a debtor contesting this element should be entitled to conduct discovery into the creditor’s application evaluation process and credit scoring systems and methods to determine what effect the falsehood actually had.

Regarding “in writing,” see *Lamar, Archer & Cofrin, L.L.P. v. Appling*, 138 S. Ct. 1752, 201 L. Ed. 2d 102 (2018) (debtor’s false statement about anticipated tax refund was statement about financial condition and was not in writing, so debt was dischargeable).

For example:

- the failure by a trustee to properly account for funds placed in their trust. *Bullock v. BankChampaign*, 569 U.S. 267, 133 S. Ct. 1754, 1759–60, 185 L. Ed. 2d 922 (2013).
 - Express or Technical Trust (not Constructive Trust)
 - The conduct at issue involves bad faith; moral turpitude; or immoral conduct
- iv. An intentional wrong, including:
- Conduct that the fiduciary knows is improper;
 - Reckless conduct of the kind that the criminal law often treats as the equivalent; or
 - Conscious disregard of a substantial and unjustifiable risk

Larceny under §523(a)(4): As a matter of federal common law larceny is:

- a. The taking property;
- b. From its rightful owner;
- c. Willfully; and
- d. With fraudulent intent.

This may be narrower than under state law, *See In re Shreve*, 386 B.R. 602 (Bankr. W.D. Va. 2008).

Embezzlement under §523(a)(4):

- a. The fraudulent appropriation;
- b. Of property belonging to another;
- c. By a person in lawful possession of that property.

Willful and/or Malicious Injury: for willful and malicious injury by the debtor to another entity or to the property of another entity

Be mindful that discharge under Chapter 13 can be different, as, for example, §1328(a)(4) has different criteria:

Comparison of Willful and/or Malice Nondischargeability in Chapter 7 and Chapter 13		
	§523(a)(6)	§1328(a)(4)
To:	An entity	An individual or the Estate of an individual
For:	Injury to Person or Property	Personal Injury or Death
By:	The Debtor	The Debtor
Intent:	Willful AND Malicious	Willful OR Malicious
Adjudication:	No restriction	Prior Civil Award for restitution or damages

Some Common Defenses:

- a. Collateral Estoppel
- b. Claim Preclusion
- c. Res Judicata
- d. Advice of Counsel Defense

i. At its heart, the advice of counsel defense is not so much an affirmative defense as it is a way for a debtor to negate the element of intent. To meet his burden on the advice of counsel defense, [the debtor] must show (1) that all facts were fully and fairly communicated to counsel; (2) that counsel gave legal advice; (3) that the debtor relied on the legal advice; and (4) that [the debtor’s] reliance was in good faith. *Rupp v. Biorge (In re Biorge)*, 536 B.R. 24, 30 (Bankr. D. Utah 2015). See also *In re Richmond*, No. 1:19CV667, 2021 WL 1195737 (M.D.N.C. Mar. 30, 2021).

ii. In the case of *United Orient Bank v. Green*, that likewise involved a § 523(a)(6) action, the court rejected the debtor’s attempt to defend a very aggressive business strategy based on the advice of counsel: “[the debtor] knew that there was, at a minimum, a substantial risk that his actions were improper and elected to run that risk ... [and the debtor] knew that his actions were ‘contrary to commonly accepted duties in the ordinary relationships among people, and injurious to’ plaintiffs.”

e. Justification/Excuse. *State Farm Fire & Cas. Co. v. Edie (In re Edie)*, 314 B.R. 6, 15 (Bankr. D. Utah 2004) (citation omitted) (“in order for an act to be willful and malicious it must be a deliberate or intentional injury (willful) that is performed without justification or excuse (malicious).”) (Quoting *Am. First Credit Union v. Gagle (In re Gagle)*, 230 B.R. 174, 181 (Bankr. D. Utah 1999)). See also *Tinker v. Colwell*, 193 U.S. 473, 485–86 (1904) (“Malice, in common will against a person, but in its legal sense it means a wrongful act, done intentionally, without just cause or excuse.” (citation omitted)).

f. Refinancing: If a refinancing was intended to eliminate the liability on the preexisting note, the debtor may be able to argue that all claims arising from that note are also extinguished. See *In re Fischer*, 116 F.3d 388 (9th Cir. 1997) (agreement that was novation of prior contract eliminated any nondischargeability claims arising out of prior contract); *In re West*, 22 F.3d 775 (7th Cir. 1994) (general release included a release of a nondischargeability claim in bankruptcy, stating, because even if the obligation arising from debtor's embezzlement would have been nondischargeable due to its fraudulent nature, no allegations of fraud surround the note, and the note substituted a contractual obligation for a tortious one). *But see United States v. Spicer*, 57 F.3d 1152 (D.C. Cir. 1995) (settlement agreement on fraud claim did not extinguish nondischargeability claims grounded in underlying debt). Settlement of a fraud case that substitutes a new contractual obligation does not eliminate the ability to claim that the underlying debt is nondischargeable due to fraud. *Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003).

2. Attorney's Fees for the Debtor if a Debt is Discharged § 523(d)

§ 727 Denial of Discharge: Most commonly brought when the debtor is alleged to have either intentionally transferred or concealed assets in order to prevent creditors from obtaining access to them in bankruptcy. Egregious fraudulent conduct strikes at the very heart of the bankruptcy but should be distinguished from legitimate exemption planning. Additionally, if the debtor has recovered substantially all of the property transferred before the bankruptcy was filed and truthfully discloses the transfers, the debtor should generally not be denied a discharge merely because the debtor did not leave assets to satisfy creditors' claims in bankruptcy when those could be protected under state or federal exemptions.

There are several explicit and implicit limitations to this action- First, the debtor must have committed the act with actual intent to hinder, delay, or defraud a creditor or officer of the estate, with constructive fraud not being sufficient. Additionally, the bad acts must both have taken place within one year prior to the bankruptcy or sometime after the bankruptcy was filed and involved property that would have been otherwise available to creditors.

Whether to Bring a §727 Adversary Proceeding: An advantage of a § 727 action compared with a § 523 action is that it can sometimes be easier. For example, to succeed under § 727(a) (4), the creditor need only show that the debtor knowingly, fraudulently, and in connection with the case made a false oath. If the debtor lied at the § 341 Meeting or Rule 2004 examination, a § 727 action might be easier to prove than a § 523 action. Further, a creditor may be able to obtain the assistance from the Trustee and U.S. Trustee given integrity of the system issues.

There are, however, substantial disadvantages for a creditor bringing a § 727 action, particularly as all other creditors will benefit from the successful prosecution of a § 727, reducing the potential recovery. Further, as a § 727 implicates the integrity of the court and the bankruptcy system, debtors are often not allowed to "buy a discharge", often making the threat of playing the § 727 "nuclear card" more valuable than actually bringing an action.

Student Loan Adversary Proceedings

Student loans are dischargeable in bankruptcy only when “undue hardship” is shown, usually under the often brutal and draconian *Brunner* test. Application of this standard has made such discharges difficult to obtain while being overly intrusive in requiring personal information from the debtor.

In November 2022, the Department of Justice (DOJ) issued a new Guidance in coordination with the U.S. Education Department (USED), that should allow bankruptcy debtors to be far more successful in obtaining discharges of their student loans by setting “clear, transparent, and consistent expectations” for discharge, reducing burdens on debtors by simplifying the process by which USED agrees to support a discharge. The Guidance provides a more objective framework for applying the three-part test courts have used in deciding undue hardship:

- **Past:** For evidence of good faith past efforts, objective criteria are used in its evaluation.
- **Present:** For the debtor’s present circumstances, the IRS Collection Financial Standards are used to determine that the debtor cannot repay the student loans while maintaining a minimal standard of living.
- **Future:** For future circumstances, there is a presumption that the debtor’s inability to repay will persist if certain circumstances apply to the debtor.

The key to the new process is bankruptcy debtors completing an Attestation Form to seek the DOJ’s agreement to settle the debtor’s undue hardship discharge proceeding.

Sources and Other Resources

- 11 U.S.C § 523(a)(2) and (4):
 - [Dreher, Nancy C. and Roy, Matthew E. \(1993\) *Bankruptcy Fraud and Nondischargeability under Section 523 of the Bankruptcy Code*, North Dakota Law Review: Vol. 69: No. 1, Article 4.](#)
 - [Morgan Green, *No Misrepresentation Needed: Excepting Discharge for Actual Fraud Under 11 U.S.C. § 523 Without Misrepresentation*, 84 Fordham L. Rev. 2919 \(2016\).](#)
- 11 U.S.C § 523(a)(6):
 - [Matthew Harte, *A Critical Analysis of the Bankruptcy Code's Exception to Discharge for Debts Arising From Wrongful Conduct*, 4 Brook. J. Corp. Fin. & Com. L. \(2009\).](#)
- 11 U.S.C § 523(a)(7):
 - [Abbye Atkinson, *Consumer Bankruptcy, Nondischargeability, and Penal Debt*, 70 Vanderbilt Law Review 917 \(2017\).](#)
- 11 U.S.C § 523(a)(8)
 - [National Consumer Law Center, *New Process to Discharge Student Loans in Bankruptcy*](#)
- General:
 - [Norman, Jeffrey P., U.S. Bankruptcy Judge \(SDTX\), *Trial Handbook: Exceptions to Discharge in Chapters 7 and 13* \(2019\).](#)
 - [Tucker, Thomas, Clayson, Kimberly, Kochis, Anthony, and Turner Lewis, Wendy, *Prosecuting and Defending § 523 Adversary Proceedings*, 2018 Hon. Steven W. Rhodes Consumer Bankruptcy Conference, American Bankruptcy Institute \(2018\).](#)
 - [Bankr. M.D.N.C.: Service Pursuant to Federal Rule of Bankruptcy Procedure 7004.](#)