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Bankruptcy Blotter

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Summer 2008

THE PRUDENT PRACTITIONER

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Stealth Creditors

"Stealth creditors" are persons and entities holding actual or prospective claims against the debtor that are not defined clearly by the Bankruptcy Code or identified in the official forms, but if not identified on the Schedules and mailing list, have the potential to cause debtors and attorneys grief and money. These creditors include spouses, state agencies, indemnitees, subrogees, and other holders of indirect, but legally cognizant, claims. Providing a prospective debtor with use of most software programs, copies of the official forms, or even a well-drafted questionnaire, might not elicit the necessary information if these types of claims are not presently being asserted by the holder.

The financial relief available under the Bankruptcy Code is dependent on notice given to potentially affected parties of any request for relief.

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After reading, please discuss any questions raised about any 'Stealth' Creditors you or your spouse might have.

ALL creditors should be listed. A credit report can help, but often omits these kinds of creditors.

This is because much of that relief is granted because, after notice is given to affected parties, an absence of an objection is taken as implied consent or waiver.[1] Code § 102(1)(A) defines sufficient notice as being that which "is appropriate in the particular circumstances" and expressly authorizes any judicial action without an actual hearing if notice within that definition has been given.[2]

An old doctrine from common law which has been enacted by statute in many states permits an unpaid creditor who has supplied "necessaries" to a spouse to hold the other spouse personally liable even if that spouse neither consented to, nor was aware of, the debt at the time it was incurred. This is called the doctrine of necessaries.

The Bankruptcy Courts can be stern if a notice to a creditor, or creditors, is not given—and not just on debtors. The Bankruptcy Court for the Western District of Virginia chastised a case trustee who argued that the trustee's failure to assume a lease within the Code's time period to prevent rejection by operation of law occurred because the debtor did not list the lease on his schedules. There was some evidence showing that during the first meeting of creditors the trustee had participated in a discussion of the unscheduled lease. The Court responded by holding that the trustee had "an affirmative duty to investigate for unscheduled executory contracts or unexpired leases".[3]

A plan proponent's failure to provide notice to a party entitled to it can prevent the provisions of a confirmed plan from affecting that party's rights because the claim cannot be "provided for" by the plan. In effect, the estate's liability on that claim is not modified by the plan, and the courts will not exercise their equitable powers to extend a bar date so as to bring a nondischarged, unscheduled claim inside a plan.[4] There is an exception. Where a bankruptcy estate created by the filing of a petition by a natural person has no assets that could be distributed, a failure to provide notice to a creditor in time for the creditor's participation in the estate's administration may not be fatal, but only because the creditor suffers no actual prejudice (assuming the claim is otherwise dischargeable).[5]

For business entities, insufficiency of notice has negative aspects, but many can be remedied by continuances and renoticing. For individual debtors, the failure to provide notice to a creditor can mean that the debt is not discharged. The creditor holding an otherwise nondischargeable claim which is neither listed in the mailing list or in the schedules in time to permit the timely filing of a proof of claim can assert that the debt is not affected by the discharge simply for the lack of notice, and without having to meet any other provision for nondischargeability.[6] The only defense the debtor has is a showing that the creditor had notice or actual knowledge of the pendency of the case in time to file a proof of claim, meaning the debtor or the creditor must bring an adversary proceeding to determine dischargeability on that basis.[7]

The consequence of all this is that debtors and their representatives take pains to be sure all actual and potential creditors and interest-holders are listed on the mailing list and schedules with as good an address as possible. Most debtor's attorneys will obtain a copy of the debtor's credit report for this purpose, and will ask for what must seem to the debtor like endless stacks of paper documents. Notwithstanding conscientious efforts, however, "stealth" creditors can be overlooked on schedules and a mailing list, leaving that claim potentially without notice. Stealth creditors may even be known to the attorney and the debtor, but not thought of as having a claim.

An old doctrine from common law which has been enacted by statute in many states permits an unpaid creditor who has supplied "necessaries" to a spouse to hold the other spouse *personally liable* even if that spouse neither consented to, nor was aware of, the debt at the time it was incurred.[8] This is called the doctrine of necessaries.[9] In the last decades, hospitals and other health providers have become aware of this doctrine, and are willing to assert it, particularly against widowed persons.[10] This doctrine also runs from parents to the provider of care of a child as well.[11] In effect, this doctrine permits the creditor to claim a right of subrogation to the obligation of support owed between spouses, or from a parent to a minor child.

A separated or estranged spouse is a common stealth creditor. Absent a pre- or postnuptial agreement waiving a right of support, each spouse has certain financial obligations to the other during the continuation of the marriage which are imposed by law, but which may be altered by contract. The prudent practitioner always asks if any sort of inter-spousal agreement has been made. Besides affecting the relative rights and obligations of the spouses, such an agreement may be a defense against a claim for support reimbursement based on the doctrine of necessaries or subrogation to the right of one of the spouses.

In community states, a spouse may have a right of reimbursement from community property for improvements made to that property. This right of reimbursement is unlikely to be asserted until and unless a proceeding for separation or divorce is commenced, but it exists prior to and independently of any attempt at enforcement.

So what does the Prudent Practitioner do to avoid missing a stealth creditor entitled to notice? Ask the right questions and resolve any doubt about the existence of a claim in favor of giving notice.

A separated or former spouse having an obligation to pay child support may have a claim against the other spouse for contributions to housing costs, utility bills, and other household "necessities" paid for the child's benefit while the child is not living with the obligor parent.[12] While the allowance or disallowance of such a claim is discretionary, the obligor parent has at least a contingent claim against the debtor.

Another group of stealth creditors include governmental agencies which have a potential right to assert a claim against the debtor for reimbursement for social services or Medicaid benefits paid.[13] This right need not arise from a written agreement as it is conferred by statute. For citizens who avail themselves of benefits under Medicaid, this can include claims against assets they acquire during their lifetime. However, the federal Medicaid law has an anti-lien provision which can reduce any claim for reimbursement to an unsecured claim.[14]

Watch out for creditors who had a right to possession of the debtor's property for unpaid accounts, but surrendered that possession. Surrender of a right of lien does not extinguish the debt itself. This group can include repair shops, storage unit owners and towing companies.

Caution: Including utilities for regular notice even if the debtor is believed to be current is a hazardous undertaking. Some utilities routinely demand higher or new security deposits even where no debt is outstanding.

So what does the Prudent Practitioner do to avoid missing a stealth creditor entitled to notice? Ask the right questions and resolve any doubt about the existence of a claim in favor of giving notice.

1. Provide the prospective debtor with a set of written questions going beyond the official forms that avoid using "legal" terminology and instead elicits the facts which would permit the attorney to determine whether any stealth creditors are in the offing.
2. Regularly place national and local credit "bureaus" which act as collection agencies, and check verification/clearing companies, on the initial mailing list (bur not necessarily the schedules) in any individual case, even if there is no reason to believe there is a debt as these agencies can claim interest and other fees, or be subrogated to claim of the original creditor.

   Suggestion: Remember that the defaulted debts are sold, and resold, in packages with no attempt by the seller or the buyer to verify the currency or enforceability of the debt. Warn the debtor of this practice so that if a demand letter shows up years after the bankruptcy case, the debtor will know how to proceed.
3. Include state, county, parish, and city sales taxing authorities as a matter of course if the debtor has been a control person in any business in the last two decades (yes, the agencies can and will try to reach back that far).
4. If the debtor lives in a gated community or a condominium, don't forget to include the association responsible for collecting fees for maintaining the common areas.
5. Beware of pending civic improvements. In the author's state, city-level governments like to create assessments against private property for public street "improvements".
6. Ask the debtor if any member of her or his family, or the debtor, has received at any time public or private assistance with education or medical costs.
7. If the debtor has operated a business which uses vehicles, be sure to check for any unpaid repair or maintenance facilities. As a general practice where the debtor has operated a business, ask for information regarding prospectively related services which might have surrendered a lien right.
8. If the debtor is filing alone, but is married or divorced, always include the non-filing or divorced spouse as a creditor.

Using these practices lets everyone sleep better.

NOTES:

1. In re Harvey, 213 F.3d 318 (C.A.7 (Ind.),2000); Matter of Hipp, Inc., 895 F.2d 1503, 58 USLW 2543, 22 Collier Bankr.Cas.2d 876, 20 Bankr.Ct.Dec. 418, Bankr. L. Rep. P 73,293 (C.A.5 (Tex.), March 16, 1990). See Wilburn v. Robinson, 480 F.3d 1140 (C.A.D.C.,2007) providing a good analysis of the Code's bar dates as what the Supreme Court called in Kontrick v. Ryan, 540 U.S. 443, 124 S.Ct. 906, 157 L.Ed.2d 867 (2004) "claim-processing". Further, an order entered without objection can be found to be preclusive of the issues in it. Allied Pilots Ass'n v. Pension Ben. Guar. Corp., 334 F.3d 93 (C.A.D.C.,2003).
2. 11 U.S.C.A. 102(1)(B).
3. In re Bane, 228 B.R. 835 (Bkrtcy. W.D.Va., 1998), affm'd at In re Bane, 182 F.3d 906, 11 Fourth Cir. & D.C. Bankr. 508 (4th Cir.(Va.) Jul 14, 1999). Accord, In re Vecchitto, 235 B.R. 231 (Bkrtcy. D.Conn.,1999) (debtor's failure to scheduled an executory contract did not toll the running of the 60-day period; trustee aware of existence of contract well before commencement of bankruptcy case).
4. Matter of Smith, 21 F.3d 660 (C.A.5 (La.),1994) (debtor could have learned the creditor's address by picking up the telephone, and failure to do so was more than mere negligence or inadvertence). This decision was cited with approval on similar facts in Matter of Faden, 96 F.3d 792 (C.A.5 (Tex.), 1996). Accord, Neal v. Oak Brook Management Corp., 373 Ill.App.3d 153 (Ill.App. 2 Dist., 2007).
5. The leading case on this is In re Beezley, 994 F.2d 1433 (9th Cir. 1993). This is still good law. In re Vizzini, 348 B.R. 339, 345 (Bankr. E.D.La. Apr 11, 2005).
6. 11 U.S.C.A. §523(a)(3). See In re Kimball, Slip Copy, 2008 WL 1319631 (Bkrtcy.E.D.Cal.,2008) (merely reopening the case to amend the schedules to add the creditor not enough to make claim dischargeable).
7. 11 U.S.C.A. §523(a)(3)(A).
8. N.A.R., Inc. v. Elmer, 141 P.3d 606 (Utah App., 2006) (interest and attorney's fees in contract between wife and medical provider were not family expenses for which husbande was liable, even though spouse was liable for principal debt resulting from wife's medical treatment).
9. See, generally, Wife's liability for necessaries furnished husband, 11 A.L.R.4th 1160, and Modern status of rule that husband is primarily or solely liable for necessaries furnished wife, 20 A.L.R.4th 196.
10. But not always successfully. See Heinemann v. John F. Kennedy Memorial Hosp., 585 So.2d 1162 (Fla.App. 4 Dist. 1991) (hospital sued widow for unpaid medical expenses incurred by deceased husband; widow not liable absent agreement with provider).
11. Schmidt v. Mutual Hosp. Services, Inc., 2005 WL 1877175 (Ind. App.,2005) (parents' religious objections to child's medical treatment did not negate parental obligation to provide necessary medical care for child or corresponding duty to pay).
12. Mizell v. Mizell, 839 So.2d 1222 (La.App. 2 Cir.,2003). See, generally, Right to Credit on Child Support for Contributions to Housing Costs, Utility Bills, and Other Alleged Household Necessities Made for Child's Benefit While Child is Not Living with Obligor Parent, 123 A.L.R.5th 565 (2004).
13. 42 U.S.C.A. §1396a(a)(25)(A) mandates that a state's medical assistance program must include a requirement that the state or local agency administering the plan take "all reasonable measures" to ascertain the legal liability for reimbursement of payments made of all third parties. In effect, the state becomes subrogated to the rights of any person or individual providing those services.
14. Arkansas Dept. of Health and Human Services v. Ahlborn, 547 U.S. 268, 126 S.Ct. 1752 (U.S.,2006) (anti-lien provision of Medicaid law precluded Arkansas statute's encumbrance or attacfhment of proceeds related to damages other than medical costs). For the mess that is Medicaid reimbursement, see Health Law Handbook, 2006 Health L. Handbook §6:7 "Medicaid reimbursement rate litigation and legislative proposals–Litigation".