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The Community Property Discharge in Bankruptcy: A Fair Result or a Creditor's Trap

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In a recent case in the District of New Mexico a debtor who had defrauded several persons filed bankruptcy. The victims of this fraud objected to the discharge of the debts arising from fraud. The debtor pleaded as an affirmative defense that the discharge of his wife in a previous bankruptcy had discharged him of the debts, which the parties had conceded were community debts. The debtor won, and the creditors were barred from reaching any community property for satisfaction of their debts.¹

The above case seems unfair. A basic principle of bankruptcy law is that a discharge should only be granted to an "honest but unfortunate debtor."² In the above case, however, the exact opposite occurred and a dishonest debtor was protected by the discharge. This seemingly inequitable result is due to a loophole in the Bankruptcy Code relating to the discharge of married couples in community property states.

The discharge gives the debtor a "fresh start" by relieving him of the burden of his debts and prohibiting creditors from pursuing the debtor after bankruptcy. In community property states, the discharge is more extensive and also protects community property acquired after the discharge, regardless of whether one or both spouses file bankruptcy. Thus, a debtor's spouse who does not file bankruptcy also gets relief through the discharge. In this way the fresh start is given full effect, because if creditors could pursue a nonfiling spouse after the bankruptcy on a community debt, the fresh start would be a nullity.

Although the community property discharge has the positive result of giving full effect to the discharge of a married couple in a community property state, it does not provide protection against dishonest spouses. The Bankruptcy Code sets forth fifteen exceptions to discharge, as well as a general denial of discharge for the wrongdoing debtor.³ In order to recover from the debtor, the creditor must prove that debts are nondischargeable. Additionally, the creditor must often contend with strict

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¹ Gonzales v. Costanza (In re Costanza), 151 B.R. 588 (Bankr. D.N.M. 1993). A full discussion of this case is found infra at notes 64-78 and accompanying text.

² Brown v. Felsen, 442 U.S. 127, 128 (1979) (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244(1934)).

time limits in some cases. These strict time limits gave a debtor and his or her dishonest spouse the opportunity to be deceitful. An honest spouse can file bankruptcy while the dishonest spouse lurks in the shadows. A creditor receives notice of the honest spouse’s bankruptcy and does not make the link to the dishonest spouse. The time to object to the discharge runs out and the discharge which applies to the marital community is issued. The discharge bars the creditor from pursuing the community property of the dishonest spouse who did not file bankruptcy. As a leading author on this subject aptly stated, “the Devil himself could effectively receive a discharge in bankruptcy if he were married to Snow White.”

The purpose of this article is to explain the community discharge to enable creditors to effectively pursue their claims in bankruptcy court. In order to understand the discharge with regard to community property it is necessary to analyze the discharge in general in the context of a Chapter 7 bankruptcy. Subsequently, the article will outline the community discharge with respect to the injunction created by the section, and the determination of whether a creditor has a community claim subject to the community discharge. Finally, the article will address the “hypothetical” discharge actions which are required to be brought by a creditor and the problem of the lack of adequate notice that a creditor receives from the nonfiling spouse.

I. CHAPTER 7 DISCHARGE

The discharge is most clearly explained in the context of Chapter 7 individual bankruptcy. When a debtor files a voluntary bankruptcy he receives an “order of relief.” Immediately, a broad automatic stay goes into effect which gives the creditor a breathing spell. Upon entry of the order for relief, a bankruptcy estate is created which includes “all legal or equitable interests of the debtor in property as of the commencement

4. See 11 U.S.C. § 523(c) (amended 1994); FED. R. BANKR. 4007(c). For a full discussion of the problem of time limits on objections to the discharge of a debt, and notice to creditors of the time limits to object, see infra notes 23-24, 111-32 and accompanying text. Unless otherwise noted, all references in these notes to “Code” will refer to Title 11 of the United States Bankruptcy Code.


6. Section 301 of the Code addresses voluntary cases and states that “[t]he commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.” 11 U.S.C. § 301 (1978). Under § 362 “a petition filed under section 301 . . . operates as a stay.” 11 U.S.C. § 362(a) (amended 1994). Therefore, upon filing, a stay takes effect. This stay prevents: (1) the commencement or continuation, including issuance or employment of process, of a judicial, administrative or other action or proceeding against the debtor that was or could have been commenced before the commencement of a case under this title, or to recover a claim against the debtor that arose before the commencement of a case under this title.


There are limited exceptions outlined in § 362(b)(1), but generally this provision “provides for a broad stay of litigation, lien enforcement, and other actions, judicial or otherwise, which would interfere with property of the estate, property of the debtor, or property in the custody of the estate.” L. KING ET AL., 2 COLLIER ON BANKRUPTCY ¶ 362.01 (15th ed. 1994).
of the case." 7 In community property states this also includes all interests of the debtor and his spouse in community property. 8 Thus, when a debtor files bankruptcy all community property passes into the estate. 9 A trustee is appointed who examines all property of the estate to determine if there are any assets over and above the debtor's claimed exemptions. If any assets exist the trustee distributes them to creditors on a pro-rata basis. 10

Upon filing a petition in bankruptcy, the debtor must file a list of his creditors, a schedule of his assets and liabilities, a schedule of his current income and expenses, and a statement of his financial affairs. 11 From this list the bankruptcy clerk's office sends a notice of the "First Meeting of Creditors," known in bankruptcy generally as the "341 meeting," named after the relevant section of the Code. 12 At this meeting, the creditors have the opportunity to question the debtor, under oath, concerning his financial affairs. 13

From the date of the 341 meeting a sixty-day time period begins to run during which a creditor can object to the entire discharge of the debtor under § 727, or to the discharge of particular debts under § 523. 14 With regard to particular debts, there are fifteen exceptions, known as objections to dischargeability. 15 Of the fifteen, four are subject to the

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8. 11 U.S.C. § 541(a)(2) (1988). This section provides that property of the estate includes:
   (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—
   (A) under the sole, equal, or joint management and control of the debtor;
   or
   (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
9. Id. If one spouse files in one chapter, and the other spouse files subsequently in a different chapter, community property passes into the estate of the first spouse to file. Texaco Inc. v. Bartlett (In re Bartlett), 24 B.R. 605, 608 (Bankr. 9th Cir. 1982).
10. 11 U.S.C. § 726 (amended 1994). There are special martialing rules related to distribution of community property in a Chapter 7 bankruptcy found in § 726(c). A thorough explanation of these rules is beyond the scope of this article but can be found in Pedlar, supra note 5, at 370-76.
13. Pursuant to rule 2003(a), the creditors meeting must be held between 20 to 40 days after the order of relief. Under rule 2003(b)(1), "[t]he business of the meeting shall include the examination of the debtor under oath and in a Chapter 7 liquidation case, may include the election of a trustee or of a creditor's committee." Fed. R. Bankr. 2003(b)(1). The purpose of the examination is to make a determination as to whether the assets have been concealed, improperly disposed of or if there are grounds for objections to discharge." L. King et al., 2 COLLIER ON BANKRUPTCY ¶ 341.02 (1994) (citing H.R. No. 595, 95th Cong., 1st Sess. 331 (1977)).
14. Fed. R. Bankr. 4004(a), 4007(c). The time limits run from the first date set for the Meeting of Creditors, not any continuations of the meeting thereafter. In re Bowman, 800 F.2d 520 (5th Cir. 1986); Delesk v. Rhodes (In re Rhodes), 61 B.R. 626 (Bankr. 9th Cir. 1986).
15. As a matter of good practice it is important to keep distinct the objection to the discharge of a debtor as opposed to the objection to the dischargeability of the debtor. The objection to discharge is a harsh result which denies the debtor of any relief of his debts. With an objection to dischargeability, however, a debtor may still receive a general discharge and have only one debt excepted from discharge.
sixty-day rule. The four types of debts subject to the rule are those pursuant to §§ 523(a)(2), 523(a)(4), 523(a)(6) and 523(a)(15) and include debts arising from false pretenses, false representation, or actual fraud; fraud or defalcation while acting as a fiduciary, or embezzlement; willful and malicious injury; and debts arising out of a separation or divorce decree.

The creditor has an affirmative duty to bring an objection to dischargeability if the objection is based on §§ 523(a)(2), (4) or (6). The creditor must object by filing a complaint in an "adversary proceeding" which is a mini-lawsuit within the bankruptcy. Nevertheless, as the time

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16. Section 523(a)(2) provides that a debtor is not discharged from a debt:
   (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—
      (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

17. Section 523(a)(4) provides that a debtor does not receive a discharge for a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny ...." 11 U.S.C. § 523(a)(4). Fraud or defalcation is modified by the phrase "acting in a fiduciary capacity." L. KING ET AL., 3 COLLIER ON BANKRUPTCY ¶ 523.14 (15th ed. 1994). This type of fraud or defalcation is limited to technical or express trusts. Id. If a creditor wants to bring a general fraud claim it does so under § 523(a)(2).

18. Section 523(a)(6) provides that a debtor does not receive a discharge for a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). The section is applied to debts arising from intentional torts, or willful and malicious conversions of property. Some courts uphold a strict standard, more protective of the debtor, which sets a high standard for what is willful and malicious conduct. Other jurisdictions follow a less severe standard. This split of authority was discussed in Gilchrist v. Pattison (In re Pattison), 132 B.R. 449, 450 (Bankr. D.N.M. 1991).

19. 11 U.S.C § 523(a)(15) (amended 1994) provides that a debtor is not discharged from a debt:
   (15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with state or territorial law by a governmental unit unless—
   (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation and operation of such business; or
   (B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child or the debtor.

This exception became effective October 22, 1994, with the enactment of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994). Generally, the section is intended to provide a greater protection for alimony, maintenance or support obligations, but as of the time of the writing of this article there are no reported decisions interpreting this provision.

20. 11 U.S.C. § 523(c) (amended 1994). See In re Compton, 891 F.2d 1180, 1185 (5th Cir. 1990), in which the court noted that "[Section] 523(c) of the Code . . . places a heavy burden on the creditor to protect his rights . . . ." Id. (quoting Neeley v. Murchison, 815 F.2d 345, 347 (5th Cir. 1987)). But see creditors excepted in § 523(c)(2).

21. Rules 7001 to 7087 govern adversary proceedings. In most cases the bankruptcy rule adopts, or is substantially similar to the federal rules of civil procedure.
limits are jurisdictional, an extension to object to discharge or dischargeability can only be granted if filed within the sixty days. The remaining exceptions to dischargeability in § 523 can be raised at any time. If there are no objections to discharge or dischargeability, then the court “shall forthwith grant the discharge.” The debtor is then discharged from “all debts that arose before the date of the order for relief”.

The Chapter 7 discharge should be thought of in terms of a time line. This line is created when the debtor files the bankruptcy petition. All debts before that point (known as pre-petition debts) are discharged. The debtor is not discharged of any post-petition debts he incurs. The discharge protects the debtor from having any personal liability on pre-petition debts, unless a creditor successfully objects to discharge or dischargeability.

The discharge is limited in three respects. First, the discharge extends only to the personal liability of the debtor. A creditor with a debtor’s mortgage, for example, still has an “in rem” right relating to his collateral and a lien which survives the bankruptcy. The creditor can foreclose on that lien, but may not seek a deficiency judgment against the debtor.

Second, as noted above, if a creditor wants to file a complaint to object to dischargeability for the debts other than §§ 523(a)(2), (4), (6) or (15) he can do so at any time. Even if a bankruptcy case has been closed, it “may be reopened without the additional payment of a filing fee” to pursue one of these debts. This provision is the result of legislative determination that certain types of debts should be more difficult to discharge. For example, a debt arising from a drunk driving accident may be raised at any time, as well as a debt to collect child support.

23. The rules on extensions of time clearly state that extensions of time must be made before the expiration of the sixty days. See rules 4004(b) and 4007(c) which both provide that the court for cause may extend the time. Both rules also clearly state “[t]he motion shall be made before the time has expired.” In addition, the bankruptcy court has no discretion to extend the time if the motion is not filed within the sixty days. The bankruptcy rule on enlargement of time, clearly limits the court to enlarge the time “only to the extent and under the conditions stated” in rules 4004(a) and 4007(c). Fed. R. Bankr. 9006(b)(3).
24. Rule 4007(b) states “[a] complaint ‘other than under § 523(c) may be filed at any time.’” Fed. R. Bankr. 4007(b) (emphasis added). 11 U.S.C. § 523(c) (amended 1994).
25. Fed. R. Bankr. 4004(c). For example, in Chapter 7 in the District of New Mexico, if there are no objections to discharge or dischargeability the discharge will often be granted on the day after the time period to object to discharge and dischargeability runs, that is the sixty-first day after the first meeting of creditors.
27. A trilogy of United States Supreme Court opinions uphold this concept. See Johnson v. Homestate Bank, 111 S. Ct. 2150, 2154 (1991) (holding that “a bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor in personam—while leaving intact another—namely an action against the debtor in rem.”); Farrey v. Sanderfoot, 111 S. Ct. 1825, 1829 (1991) (holding that “ordinarily liens and other secured interest survive the bankruptcy.”); Dewsnup v. Timm, 112 S. Ct. 778 (1992) (upholding the Bankruptcy Act concept that “a lien on real property passes through the bankruptcy unaffected.”).
Third, the discharge is generally limited to those debts scheduled by the debtor. Under § 523(a)(3), a creditor who had no actual knowledge of the bankruptcy and whose debts were "neither listed nor scheduled under section 521(1)" in time to permit timely filing of a proof of claim or dischargeability action are not discharged. This provision protects creditors from missing the date to file a proof of claim and share in the estate's distribution, or from missing the date to object to discharge or dischargeability.

With regard to the community discharge, § 523(a)(3) does not aid creditors who are unaware of the malfeasant spouse. A community debt will most likely be listed and scheduled in the honest spouse's bankruptcy. Therefore, even though a creditor may not realize the debtor's connection to the wrongdoing spouse, the creditor does not fall under the exception just because he may be without "notice or actual knowledge." Lack of notice of the nonfiling spouse's existence and potential for discharge will not be sufficient where the creditor is listed.

A practice related to the scope of the discharge in bankruptcy is a procedure known as lien avoidance. Pursuant to § 522(f) of the Bankruptcy Code, a debtor is allowed to "avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption." This procedure is limited to judicial liens, and "nonpossessory, non-purchase money security interest[s]" in household goods, tools of the trade, or professionally prescribed health care aids.

A simple example of lien avoidance is where the debtor takes out a consumer loan to purchase household goods. Household goods as a practical matter have a very low resale value. The Bankruptcy Code allows the debtor to avoid the lien to the extent that it impairs the debtor's exemption in household goods. Under the Bankruptcy Reform Act of 1994, if the sum of all of the liens as well as the debtor's

30. Specifically, Section 523(a)(3) sets forth that a debtor is not discharged from a debt:
   (3) neither listed nor scheduled under section 521(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; or
   (B) if such debt is of a kind specified in paragraph (2)(4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.

31. Although it is the general rule following the Bankruptcy Code that a debt must be listed or scheduled to be discharged, recent authority holds that in a no-asset Chapter 7 bankruptcy (a bankruptcy where there is no distribution) even unscheduled creditors can be discharged. Bezley v. California Land Title Co. (In re Bezley), 994 F.2d 1433 (Bankr. 9th Cir. 1993).

32. In addition, if the creditor is in a no-asset Chapter 7 bankruptcy, the protection of § 523(a)(3) has been eroded by recent precedent. See id.


34. Id.

exemption exceeds the value of the property, the lien can be avoided entirely. Prior to this amendment, the lien was only avoided to the extent it impaired an exemption. Under the old law, repossessions which were not worthwhile were discouraged, and debtors were allowed to keep their household goods. Although the lien under the old law was not really discharged, it was not worth pursuing and therefore the debtor effectively received a discharge because the creditor would often do nothing. Under the new law, although the lien is not "discharged" it may be "avoided" entirely and therefore is not effective after the bankruptcy.

II. THE DISCHARGE INJUNCTION

When the debtor receives a discharge the stay is terminated, but § 524, the discharge injunction, acts in the same manner as the stay. Section 524 is entitled "Effect of Discharge" and creates an injunction which prohibits creditors from pursuing the debtor on debts which were discharged. Even if the creditor obtains a judgment on a discharged debt, the judgment is "void." The section was added to the Code in 1970 to stop creditor abuses which were occurring post-discharge. Prior to the amendment, a creditor could file suit against the debtor for a pre-petition debt. The debtor was then required to plead the discharge as an affirmative defense in state court. Often, debtors who had legitimately received a discharge of the debt failed to file a timely answer and were defaulted. Section 524 precludes creditors from engaging in this abuse and gives the discharge teeth. A debtor can recover damages for violation of the discharge injunction and have the creditor held in contempt of court. These damages

36. The stay continues until the earliest of these three occurs: 1) closing, 2) dismissal of the bankruptcy, or 3) the grant or denial of discharge. 11 U.S.C. § 362(c)(2) (1988).
37. This section provides:
§ 524 Effect of Discharge.
(a) A discharge in a case under this title—
(1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, 1228, or 1328 of this title, whether or not discharge of such debt is waived;
(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived . . . .
38. Id. at 524(a)(1).
40. Id. The Collier treatise cites the following legislative history:
Under present law creditors are permitted to bring suit in State courts after a discharge in bankruptcy has been granted and many do so in the hope the debtor will not appear in that action, relying to his detriment upon the discharge.
Id. ¶ 524.01 (citing H.R. No. 91-1502, 91st Cong., 2d Sess. 1-2 (1970)).
41. Id.
usually include the costs of defending the action, but do not include punitive damages.\textsuperscript{42}

III. THE COMMUNITY DISCHARGE

The discharge injunction further protects after-acquired community property and is the source of the concept of the "community discharge." The community discharge is set forth in §§ 524(a)(3) and 524(b) of the Bankruptcy Code. Section 524(a)(3) provides:

§ 524 Effect of Discharge.
(a)(3) A discharge in a case under this title ... operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1228(a)(1) or 1328(a)(1) of this title, or that would be so excepted, determined in accordance with the provisions of section 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.\textsuperscript{43}

Section 524(b) provides:

(b) Subsection (a)(3) of this section does not apply if—

(1)(A) the debtor's spouse is a debtor in a case under this title, or a bankrupt or a debtor in a case under the Bankruptcy Act, commenced within six years of the date of the filing of the petition in the case concerning the debtor; and

(B) the court does not grant the debtor's spouse a discharge in such case concerning the debtor's spouse; or

(2)(A) the court would not grant the debtor's spouse a discharge in a case under Chapter 7 of this title concerning such spouse commenced on the date of the filing of the petition in the case concerning the debtor; and

(B) a determination that the court would not so grant such discharge is made by the bankruptcy court within the time and in the manner provided for a determination under section 727 of this title of whether a debtor is granted a discharge.\textsuperscript{44}

Sections 524(a)(3) and 524(b) represent a compromise Congress reached in an attempt to resolve competing policies unique to bankruptcy in community property states. The problem is whether after-acquired com-

\textsuperscript{42} See e.g., In re McNeil, 128 B.R. 603 (Bankr. E.D. Pa. 1991) (enforcement of discharge injunction may include holding violators in contempt); In re Roush, 88 B.R. 163 (Bankr. S.D. Ohio 1988) (creditor not cited for contempt but reasonable attorney's fees and costs awarded); and In re Brantley, 116 B.R. 443 (Bankr. Md. 1990) (debtor not entitled to punitive damages).
\textsuperscript{43} 11 U.S.C. § 524(a)(3).
\textsuperscript{44} 11 U.S.C. § 524(b).
munity property of the spouses should be accessible for pre-bankruptcy community claims of the nonfiling spouse, or whether the creditors who participated in the distribution of assets in a bankruptcy should be limited to that distribution.\textsuperscript{45} Those who think that creditors should not be allowed to pursue a nonfiling spouse after the discharge argue that the creditors "have already had 'one bite' at the community property apple,"\textsuperscript{46} by virtue of the bankruptcy distribution. On the other hand, one can argue that a discharge is only intended for the debtor who submits himself to the bankruptcy.\textsuperscript{47}

The problem of the community discharge is further complicated by trying to answer the question by looking at the motives for filing bankruptcy. If a wrongdoing spouse does not file simply to avoid objections to discharge or dischargeability, it is unfair to let that spouse hide behind the discharge of the honest spouse. On the other hand, some spouses would prefer not to file bankruptcy and have not participated in any type of wrongdoing which gives rise to a nondischargeable debt. The honest spouse with a legitimate motive for not filing bankruptcy should not be forced to file solely to protect post-petition community property, such as earnings, from the hands of creditors.

There is no clear answer to reconcile the debate arising out of these competing policies. The scheme of §§ 524(a)(3) and 524(b) tries to effect a compromise by allowing creditors to object "hypothetically" to the discharge or dischargeability of a non-filing spouse, while still allowing both spouses to be protected by the discharge even when only one files bankruptcy. By allowing a creditor to object to the discharge or dischargeability of the nonfiling spouse, the statute permits "the economic sins of either spouse to be forever visited upon the community property."\textsuperscript{48}

\textbf{A. Section 524(a)(3) – The Injunction and Determination of Community Claims Subject to the Community Discharge}

To fully understand § 524(a)(3) it is necessary to analyze the provision in the three following components: the language creating an injunction protecting post-petition community property; the language specifying that the section applies to community claims, and the language relating to dischargeability actions.

1. The Injunction

The injunctive nature of § 524(a)(3) is an important concept to comprehend, for if it is glossed over, one may overestimate the protection that the section provides. Although this article uses the term "community

\textsuperscript{45} L. King et al., 3 Collier on Bankruptcy ¶ 524.02 (15th ed. 1994).
\textsuperscript{46} Id. The phrase is attributable to Alan Pedlar, supra note 5, at 380.
\textsuperscript{47} L. King et al., 3 Collier on Bankruptcy ¶ 524.02 (15th ed. 1994).
\textsuperscript{48} Pedlar, supra note 5, at 382. The quote is "attributable to Richard Levin, majority counsel to the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary of the House of Representatives and one of the primary draftsmen of the new Code." Id. at n.122.
discharge,” which is also known as the “split discharge,” it is only to utilize the term as it is commonly applied by practitioners. The terminology is inexact, however, because § 524(a)(3) is an injunction and not a discharge.\textsuperscript{49} In fact, the community discharge is limited in that it only applies to those who remain married, and does not apply to separate property. Three cases illustrate this point.\textsuperscript{50}

The community discharge applies only to married persons. For example, in \textit{In re Von Burg},\textsuperscript{51} an ex-spouse of a debtor tried unsuccessfully to assert that she was protected by the community discharge because her ex-husband had received a discharge in bankruptcy. In 1978, John and Meri Von Burg signed two promissory notes to the Stockton Teachers Credit Union (STCU) while they were married. The couple was jointly and severally liable for the amount due on the note.\textsuperscript{52} On July 3, 1979, the couple obtained a divorce.\textsuperscript{53} According to the property division agreement, John Von Burg would be responsible for the notes to STCU.\textsuperscript{54} He defaulted on the notes.\textsuperscript{55} A suit for collection was filed against both John Von Burg and Meri Von Burg, and judgment was entered against both parties.\textsuperscript{56} John Von Burg filed bankruptcy and discharged the debt.\textsuperscript{57} The collection agent then proceeded to file suit against Meri Von Burg for the full amount owing.\textsuperscript{58} Meri Von Burg brought an adversary proceeding in her ex-husband’s bankruptcy to enjoin further collection against her in the state court.\textsuperscript{59}

The bankruptcy court held that since the Von Burgs were divorced prior to the filing of bankruptcy, no community property came into the bankruptcy estate pursuant to § 541. The court arrived at this conclusion based on the theory that upon the dissolution of the marriage, the property once considered community property became the “common property of the two.”\textsuperscript{60} Further, the court held that the relevant language in § 524(a)(3) only applied to one who was a spouse of the debtor on the date of filing, and to after-acquired community property.\textsuperscript{61} Since Meri Von Burg was not a spouse on the date the debtor filed bankruptcy and because there was no community property to protect after the discharge, the section was inapplicable.\textsuperscript{62} The bankruptcy court further held that the

\begin{thebibliography}{99}
\bibitem{51} 16 B.R. 747.
\bibitem{52} \textit{Id.} at 748.
\bibitem{53} \textit{Id.}
\bibitem{54} \textit{Id.}
\bibitem{55} \textit{Id.}
\bibitem{56} \textit{Id.}
\bibitem{57} \textit{Id.}
\bibitem{58} \textit{Id.}
\bibitem{59} \textit{Id.}
\bibitem{60} \textit{Id.} at 749 (citing Daut v. Daut, 220 P.2d 63 (1950). \textit{See supra} note 8 for the language of § 541(a)(2).
\bibitem{61} \textit{Von Burg}, 16 B.R. at 749.
\bibitem{62} \textit{Id.}
\end{thebibliography}
community discharge was not intended for those who do not remain married, and the policies of § 524(a)(3) "would not be furthered by permitting the ex-spouse of a debtor to take advantage of the debtor’s discharge to avoid her personal obligations." 63

_Von Burg_ clarified some issues for couples who contemplate bankruptcy while also considering divorce. In this situation, the husband and wife should either both file a joint petition, or file separately, in order to obtain individual discharges. Individuals in this situation should not rely on the community discharge, which will not help them upon dissolution of the marriage. The court in _Von Burg_ also noted that only community property is protected. Thus, the separate property of an individual is not protected by the community discharge. This concept was more clearly addressed in _In re Costanza_ and _In re Strickland_.

In _In re Costanza_,64 the bankruptcy court considered whether a complaint under § 523(a)(2), to except a fraudulent debt from discharge, was barred by the previous bankruptcy of the debtor’s wife. The facts of _Costanza_ flow out of two state court suits and two separate bankruptcies. The first suit, in 1985, was for criminal fraud against Edward Costanza.65 Edward Costanza pled guilty and was ordered to pay restitution.66 Additionally, two plaintiffs sued Costanza in 1985 in civil court for fraudulent acts.67 Subsequently, both Carolyn and Edward Costanza filed bankruptcy.68

On December 18, 1985, Edward’s wife Carolyn Costanza filed a Chapter 7 bankruptcy.69 Because Carolyn filed bankruptcy subsequent to Edward’s civil suit, the bankruptcy had to determine how it would treat the debt resulting from Edward’s fraudulent conduct. The parties conceded that it would be a community debt.70 The bankruptcy schedules listed the debt arising from Edward’s fraudulent acts as to one plaintiff. The other plaintiff, though not listed, had actual knowledge of the bankruptcy.71

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63. Id. at 749.
64. 151 B.R. 588 (Bankr. D.N.M. 1993).
66. 151 B.R. at 589.
68. _Costanza_, 151 B.R. at 589. The opinion finds that Carolyn Costanza filed bankruptcy in 1985. Edward Costanza, who had been convicted of fraud, filed bankruptcy in 1992. _Id._
69. _Id._
70. The parties conceded this issue. However, the community nature of the debt could have been based upon New Mexico law, for the fraud was probably a “community tort” which benefitted both Edward and Carolyn. See Delph v. Potomac Ins. Co., 95 N.M. 257, 620 P.2d 1282 (1980). In the alternative, the debt was a community debt as defined by the Bankruptcy Code definition of community claim set forth in 11 U.S.C. § 101(7).
71. The bankruptcy court generally found that the plaintiffs “were either scheduled creditors or had actual knowledge of her [Carolyn Costanza] bankruptcy in time to have filed such a complaint.” _In re Costanza_, 151 B.R. at 589. The exhibits attached to the complaint revealed that one plaintiff had been scheduled and the other plaintiff had knowledge imputed through his attorney because one attorney represented both plaintiffs. Adversary Proceeding 92-1044 R, Defendant’s Amended Memorandum of Points and Authorities and Statement of Material Facts, filed November 17, 1992 at ¶ 13.
The plaintiffs did not object hypothetically to the discharge of Edward Costanza in Carolyn’s bankruptcy. As discussed below, the hypothetical objection is necessary to except the debt from discharge. Carolyn Costanza received a discharge and the community discharge came into effect.

Six years later, Edward Costanza, the dishonest spouse, filed bankruptcy. The plaintiffs objected to the dischargeability of their debts because they were allegedly procured by fraud. Edward Costanza asserted as an affirmative defense that the discharge of his wife had effectively discharged his debts as well.

The court dismissed the defendant’s contention and held that “[d]efendant’s liability remains, but the sources against which it may be enforced have been reduced.” Because Edward had pled guilty to criminal fraud, it was clear that his personal liability for fraud on the dischargeability claim could “hardly be disputed.” However, the bankruptcy judge held that the community property of the two was protected because Carolyn Costanza had received a discharge which, as the court noted, “shield[ed] all her after acquired property from the claims of her creditors, including community claims based upon her husband’s wrongdoing.” Further, the court held that “if he [Edward] does not treat her better than his creditors, she will, by divorcing him, deny his discharge.”

In this way, the discussion in In re Costanza clarified the proposition in In re Von Burg. In re Costanza established that the defendant is liable, notwithstanding the community discharge. Nonetheless, the debtor effectively received a discharge because he had no significant separate property for his creditors to pursue. In addition, the bankruptcy court’s quip that the Carolyn Costanza could deny the discharge of Edward by divorcing him affirms the holding of In re Von Burg that § 524(a)(3) is meant to apply only to married persons. Thus, a divorce subsequent to bankruptcy can undo the protection of the community discharge.

In re Strickland supports the propositions of the two preceding cases. In Strickland, the debtor filed bankruptcy but his wife did not join him in the bankruptcy petition. The debtor added a creditor to the schedules post-petition and the creditor received adequate notice of the bankruptcy. The creditor was an attorney who had done work for Mr. Strickland’s wife while the Stricklands were married.

73. Id.
74. Id.
75. Id.
76. Id.
77. Id.
78. Id. at 590.
80. Id. at 910.
81. At the time the case took place the district of New Mexico allowed a debtor to give a creditor a “special notice” of his bankruptcy if the debtor accidentally omitted a creditor. This procedure no longer exists.
82. In re Strickland, 153 B.R. 909, 910.
The debtor contended that the community debt to the attorney had been discharged in his bankruptcy, and thus his wife could not be pursued for collection of the debt.\textsuperscript{83} The bankruptcy court, following \textit{In re Costanza}, held that the wife remained liable "but the sources against which the debt may be enforced have been reduced."\textsuperscript{84} The bankruptcy court further held that the community injunction under § 524(a)(3) "only prevents recovery, by a creditor holding a community claim," and "was not a discharge of the personal liability of the nonfiling spouse."\textsuperscript{85}

\textit{Strickland}, therefore, in accordance with \textit{In re Costanza}, established clearly that § 524(a)(3) is not a discharge for the nonfiling spouse; the personal liability for the nonfiling spouse remains. Nevertheless, if the nonfiling spouse has no significant separate property and the couple remains married, a creditor cannot pursue its debt.

These cases emphasize that § 524(a)(3) is an injunction, not a discharge. The cases also indicate that the liability of a wrongdoing spouse is not extinguished, so long as a creditor brings a dischargeability action. The creditor may be hindered in its collection efforts, but if the wrongdoing spouse receives an inheritance, for example, the dischargeability judgment obtained would attach at that time. As a matter of good practice, creditors should pursue dischargeability actions so as to allow for potential collection, even if the wrongdoing spouse does not presently have separate property. Any judgment obtained, however, would be subject to the statute of limitations of the state in which the bankruptcy took place.

a. The Injunction With Respect to Liens Avoided Under § 522(f) for Cases Filed Prior to October 22, 1994

A debtor can avoid a lien to the extent it impairs an exemption. Although the concept is simple in the context of a consumer loan as explained above, it has not been as simple with respect to judicial liens in the past. Because judicial liens are often larger than liens secured by collateral on consumer goods, the issue of the extent of the lien after the bankruptcy arises.

Prior to the Bankruptcy Reform Act of 1994,\textsuperscript{86} some cases held that debtors were only entitled to avoid judicial liens to the extent that there was equity in the property; if no equity existed, the lien could not be avoided.\textsuperscript{87} Another approach consists of looking at the total amount of liens on the property and subtract the liens from the value of the property. If any amount remained after the liens were subtracted, that amount was avoided. Under this approach, the judicial lien was not entirely avoided, but only avoided to the extent it impaired an exemption. Therefore, the lien remained an unsecured debt after the bankruptcy.

\textsuperscript{83} Id. at 911.
\textsuperscript{84} Id. at 911-912.
\textsuperscript{85} Id. at 913.
\textsuperscript{86} Pub. L. No. 103-394.
\textsuperscript{87} \textit{In re} Braddon, 57 B.R. 677 (Bankr. W.D.N.Y. 1986).
With regard to the community discharge, the judicial lien issue remains unresolved. It is unclear whether an avoided lien which survives the bankruptcy can be satisfied from community property despite the community discharge. In the case of a judicial lien on a community debt, it is arguable that it may attach to post-petition property the debtor or his/her spouse acquires, regardless of the community discharge. Thus, lien avoidance may further limit the community discharge in addition to the limitations created by the provision’s injunctive nature. Nevertheless, these concerns may be alleviated by the Bankruptcy Reform Act of 1994, which provides that the lien may be avoided entirely where no equity exists over and above the exemption.

2. Whether a Creditor has a Community Claim Subject to the Community Discharge.

The second part of the community discharge analysis involves the determination of whether the creditor has "a community claim that is excepted from discharge under §§ 523, 1228(a)(1) or 1328(a)(1) of this title . . . ."88 In other words, § 524(a)(3) prohibits collection from the community property of a debtor or his/her spouse, unless the creditor successfully brings a dischargeability action.89

The language of the section refers to a "community claim," which is defined in the Code in the following manner:

(7) "community claim" means claim that arose before the commencement of the case concerning the debtor for which property of the kind specified in section 541(a)(2) of this title is liable, whether or not there is any such property at the time of the commencement of the case.90

Although "community claim" is defined in the Bankruptcy Code, the majority of cases turn to state law to define the term.91 Authority to rely on state law in interpreting the term was established in Butner v. United States,92 which held that property interests are determined by state law. This principle was recently affirmed in Nobleman v. American Savings Bank,93 in which the Court held that "in the absence of a controlling

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89. The section refers to §§ 523, 1228(a)(1) and 1328(a)(1). Section 523 is the general section which defines nondischargeable debts. Under the Bankruptcy Code, § 523 applies in all other chapters. See 11 U.S.C. § 103 (chapter 5 of the bankruptcy code applies in chapters 7, 11, 12 and 13 of the code). The reference to § 1328(a)(1) is because these chapters limit the types of nondischargeable debts, and afford the debtor a more extensive discharge than is received under Chapter 7.
91. In re Grimm, 82 B.R. 989 (Bankr. D. Wis. 1989) (discussing whether creditor holds a community claim based on state law); accord In re Sweitzer, 111 B.R. 792 (Bankr. D. Wis. 1990); In re Strickland, 153 B.R. 909 (Bankr. D.N.M. 1993) (community debt determined by state law); cf. Valley Nat'l Bank of America v. La Sueur (In re La Sueur), 53 B.R. 414 (Bankr. D. Ariz. 1985) (finding that "state law was not controlling but nonetheless looked to state law to determine community liability of debtors).
93. 113 S. Ct. 2106 (1993).
federal rule, we generally assume Congress has 'left the determination of property rights in the assets of the bankrupts’ estate to state law,' since such property interests are created and defined by state law."94 Presumably, state law would also apply to community property interests. It is ironic, however, with regard to dischargeability actions that the Court has previously held that the determination of bankruptcy dischargeability is purely a matter of federal law.95 Thus, what law applies in a bankruptcy adversary proceeding to determine discharge or dischargeability of debt remains an open question.

Section 101(7)96 defines “community claim” and also incorporates the definition of property of the estate as it relates to community property under § 541(a)(2) of the Bankruptcy Code.97 Neither § 101(7) nor § 541(a)(2) refers the reader of those provisions to applicable non-bankruptcy law.98 Nonetheless, the leading treatise on bankruptcy suggests that § 101(7) "authorizes the participation in bankruptcy cases of entities holding claims against the debtor or non-debtor, who under applicable state law could have satisfied their claims from community property assets . . . ."99 In addition, as noted above, the majority of cases look to state law to define the term “community claim.” The reliance on state law may be based in practicality as there is no federal community property law.

On the other hand, in 1979, the Supreme Court considered the res judicata effect of a judgment based on fraud and carved out a particular exception for the applicable law in determining dischargeability actions. In Brown v. Felsen,100 a debtor stipulated to a state court judgment for a suit based on fraud.101 The debtor then filed in bankruptcy and sought to discharge the debt.102 The creditor filed an objection to dischargeability based on the debtor’s fraud.103 Claiming that the state court judgment did not contain a finding of fraud, the debtor contended that res judicata barred the claim which should have been brought in the first lawsuit.104 The Supreme Court disagreed with the debtor. The Court did not want res judicata to “shield the fraud and the cheat as well as the honest person.”105 Stating that considerations in dischargeability actions are different than those in state law collection proceedings, the Court held that dischargeability actions “are the type of question Congress intended the Bankruptcy court would resolve.”106 The Court concluded that the Bankruptcy court should engage in a full inquiry as to the alleged fraudulent

94. Id. at 2110 (quoting Butner v. United States, 440 U.S. 48, 54-55 (1979)).
97. See supra note 8 for the language of § 541(a)(2).
100. 442 U.S. 127 (1979).
101. Id.
102. Id.
103. Id.
104. Id.
105. Id. at 132.
106. Id. at 138.
acts of the debtor, and would not allow res judicata to preclude such an inquiry.\(^\text{107}\)

Questions of conflicting federal and state law continue to arise in the context of a creditor with a community claim which leads to dischargeability actions. For example, in *In re Costanza*, the creditor could have been faced with a perplexing problem. In that case, the parties conceded that the debts arising from fraud were community debts. However, without this concession the creditor would have had two choices. First, if it looked to state law to define the term “community claim,” it would have had to prove that the debt was the result of a community tort. In New Mexico, the tortious fraud of one spouse is not imputed to another, unless the community received a benefit from the fraud.\(^\text{108}\) Thus, if one spouse embezzles money, and the other spouse benefits from the embezzled funds, the debt is a community debt even though only one spouse committed the act of embezzlement. On the other hand, the creditor in *In re Costanza*, following *Brown v. Felsen*, could have relied solely on federal bankruptcy law and the definition of community claim to prove the fraud. Creditors should be aware of the possible application of either state or federal law.

3. The Language Relating to Dischargeability Actions: The Hypothetical Lawsuit a Creditor Must Bring and the Problem of Lack of Notice

As previously noted, § 524(a)(3) protects after-acquired community property unless a creditor brings a successful objection.\(^\text{109}\) Additionally, § 524(a)(3) goes further and applies to cases that “would be so excepted, determined in accordance with the provisions of 523(c) and 523(d) of this title, in a case concerning the debtor’s spouse commenced on the date of filing of the petition concerning the debtor . . . .”\(^\text{110}\) This language for the “would be” case requires the creditor to file the hypothetical case against the non-debtor spouse. Furthermore, the creditor must do so in accordance with §§ 523(c) and 523(d) of the bankruptcy code.\(^\text{111}\) As noted above, the creditor has an affirmative duty to bring a complaint objecting to dischargeability under § 523(a)(2)(4) or (6).\(^\text{112}\) Arguably, creditors have an affirmative duty to bring the hypothetical actions. In addition, the creditor must meet the sixty-day time limit in the debtor’s bankruptcy in the hypothetical case, because the case must be “commenced on the date of the filing of the petition in the case concerning the

\(^{107}\) *Id.*


\(^{109}\) The section as quoted in the text states that a debtor will have protection of the community injunction but for “a community claim that is excepted from discharge under section 523, 1228(a)(1) or 1328(a)(1) of this title . . . .” 11 U.S.C. § 524(a)(3) (amended 1994).


\(^{111}\) Section 523(c) requires that a creditor must request a hearing on the dischargeability of a debt under §§ 523(a)(2), (4), (6) or (15).

\(^{112}\) *See supra* note 20.
debtor." The sixty-day time limit stacks the odds against a creditor who has notice of an innocent spouse but may have a nondischargeable claim against a dishonest spouse. One court has skirted the issue of whether the sixty-day time limit to object to dischargeability runs in the hypothetical case, but at least two courts have held that it does apply.

Professor Alan Pedlar, the first to write on this subject, noted the restrictive provisions of bringing a dischargeability action and urged that bankruptcy rules be adopted to address the problem. These rules would require that the name of the debtor and the debtor's spouse appear on the bankruptcy petition, schedules, and 341 notice. Pedlar also suggested that the 341 notice advise creditors of the deadlines for objecting to the discharge and dischargeability of the debtor and his spouse. Finally, Pedlar would have the debtor's Statement of Financial Affairs include a question about transfers of the debtor and the nonfiling spouse. According to these provisions, creditors would have a fighting chance to object to the discharge or dischargeability of their claims.

Pedlar's points are well received by creditors who complain that insufficient notice of the nonfiling spouse unfairly deprives them of their rights. In In re Sweitzer, the bankruptcy court addressed whether a creditor received ineffective notice of the nonfiling spouse. The bankruptcy court held that the notice was ineffective but that this was not a determinative factor with respect to the effect of the community discharge.

In re Sweitzer involved an Ohio couple who had a judgment for $12,881.45 obtained against them by Central Trust Company Inc. (Central Trust). The Sweitzers then moved to Wisconsin, where Mrs. Sweitzer filed bankruptcy. Her husband was not named in the petition or schedules. Central Trust received notice of the bankruptcy and did not object to the discharge or dischargeability of debt. Subsequently, Central Trust attempted to garnish the wages of Mr. Sweitzer but the debtor claimed the protection of the discharge.

In an attempt to recover on its claim, Central Trust asserted that due process notice requirements were not met in the bankruptcy. The court relied on § 342(a) of the Bankruptcy Code which required that the clerk of the bankruptcy court shall give "such notice as is appropriate, including

114. In re Costanza, 151 B.R. 588, at n.3.
117. Id.
118. Id.
120. Id.
121. Id.
122. Id. at 793.
123. Id.
124. Id. at 797.
notice to any holder of a community claim, of the order for relief in a case under this title.”

The bankruptcy court found that notice which is appropriate for a nondebtor spouse should be the same as is appropriate for the debtor. This included the notice of the “name, social security number and employee tax identification number of the debtor and all other names used by the debtor within six years before the filing of the petition.”

Despite the finding that creditors should receive notice of the nondebtor spouse, the court held that insufficient notice had no effect on the community discharge. The court reasoned that community discharge is not effective where the creditor has successfully brought an objection to discharge or dischargeability. Therefore, according to In re Sweitzer even insufficient notice is no cause to avoid the protection of the community discharge because it is not enumerated in the statute as an exception.

Although In re Sweitzer appears to be a harsh reading of the requirement of notice, its outcome is logical considering the facts of the case. Unless a creditor has a nondischargeable claim, the creditor is not entitled to receive anything after bankruptcy, insufficient notice notwithstanding. Because In re Sweitzer did not deal with the issue of notice in the context of a creditor with a potentially nondischargeable claim, creditors who do have nondischargeable claims may still be able to argue lack of notice.

One jurisdiction has followed Pedlar’s advice with respect to the notice problem. The district of Wisconsin has adopted local rules which attempt to satisfy the notice problem. Under § 524(b), the creditor must also bring a hypothetical action if the creditor seeks to have the discharge of the non-filing spouse denied. In In re Karber the bankruptcy court determined that creditors are subject to the sixty-day time period. Therefore, creditors with a potential action to deny the discharge of a debtor are subject to the same notice problems noted above.

The issue of notice may have a broader effect than one can determine. Large institutional creditors such as credit card companies may need to implement tracking devices in their computers and/or manual systems which search for the non-filing spouse. In other words, if a creditor receives notice of the bankruptcy of one person it should determine if that person is married and the status of the accounts of the person who

125. 11 U.S.C. § 342(a) (emphasis added).
126. 111 B.R. 792, 798.
127. Id. (quoting FED. R. BANKR. 1005).
128. Id. at 799.
129. Id.
130. The rules provide that if a debtor is married and the spouse does not join the petition, the name, social security number and address of the non-filing spouse must be included on the creditor’s list, 341 notice, and on all notices pleadings and other papers. Local Bankr. R. 5.01 (E.D. Wis. 1994). In addition, a non-filing spouse’s earnings and expenses must be disclosed. Local Bankr. R. 5.03. The rules also require disclosure of transfers between spouses. Local Bankr. R. 5.05.
did not file, if any. For example, a wrongdoing spouse could run up a large credit card bill just before filing. This can be a nondischargeable debt.\textsuperscript{132} If the spouses have separate accounts this may not show up even though the debt may be a community debt. A tracking system for spouses could alleviate this problem. Additionally, counsel for creditors should ask questions about the nonfiling spouse at the 341 meeting in order to prevent community discharge problems.

In conclusion, the community discharge allows only one spouse to file for both spouses to receive a discharge of community debts. A creditor's only avenue is to file a hypothetical action objecting to discharge or dischargeability of debts. Because notice of the nonfiling spouse is ineffective, counsel and creditors should think of alternative methods of obtaining information. In this way, creditors might be able to catch the Devil even if he is married to Snow White.