AMERICAN BANKRUPTCY INSTITUTE

Winter Leadership Conference

A Fraud or Not a Fraud, That Is the Question: Litigating Fraud in Consumer Cases

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CONCURRENT WORKSHOP

2023

ABI Winter Leadership
December 2023
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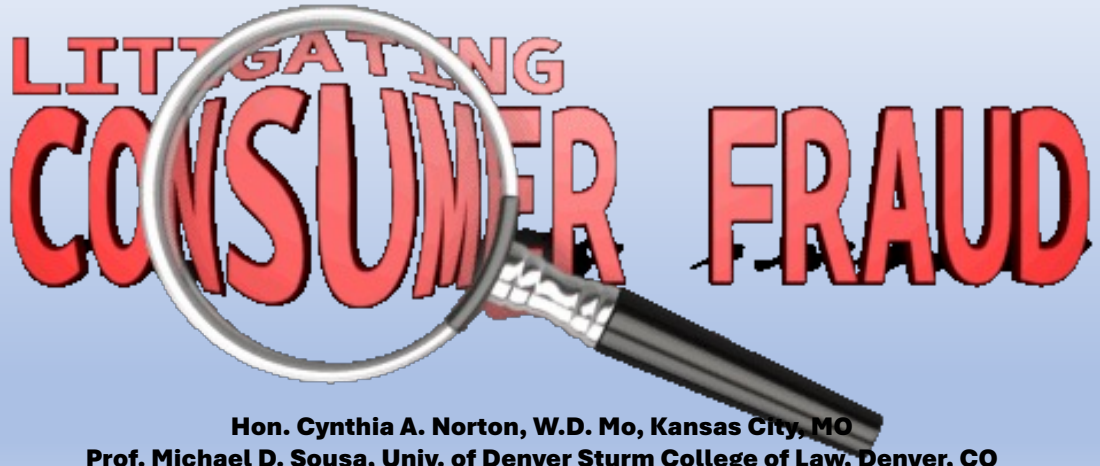

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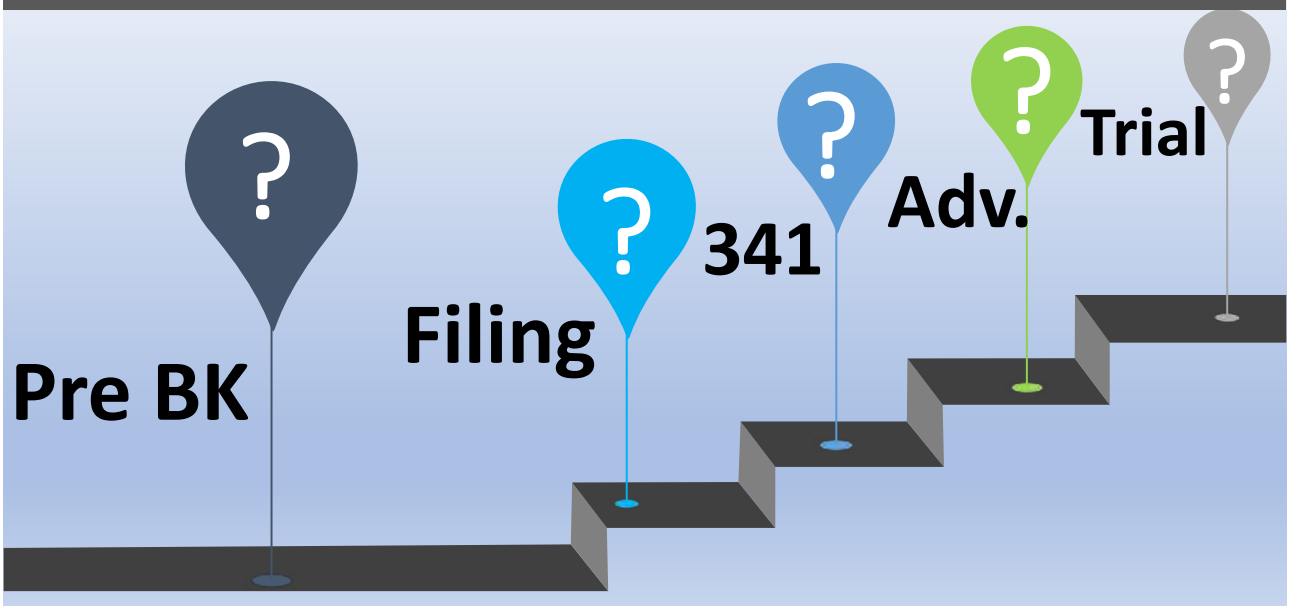

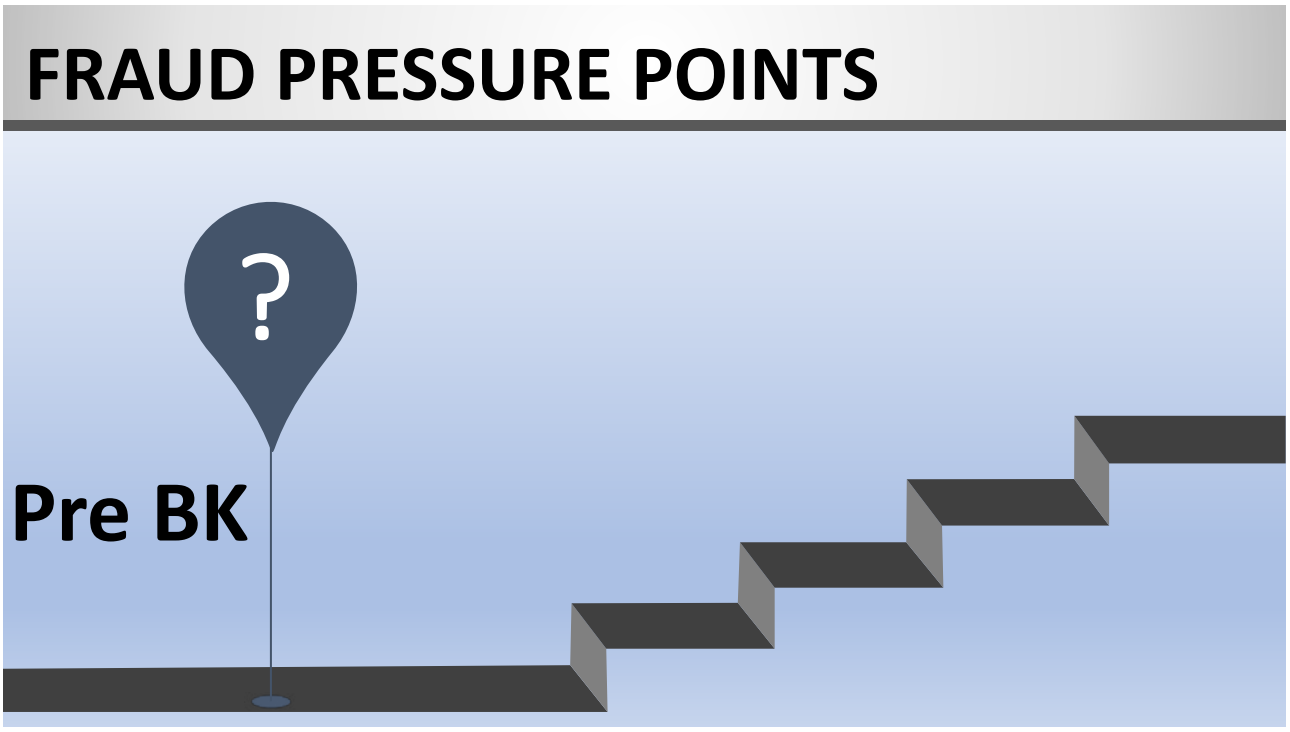
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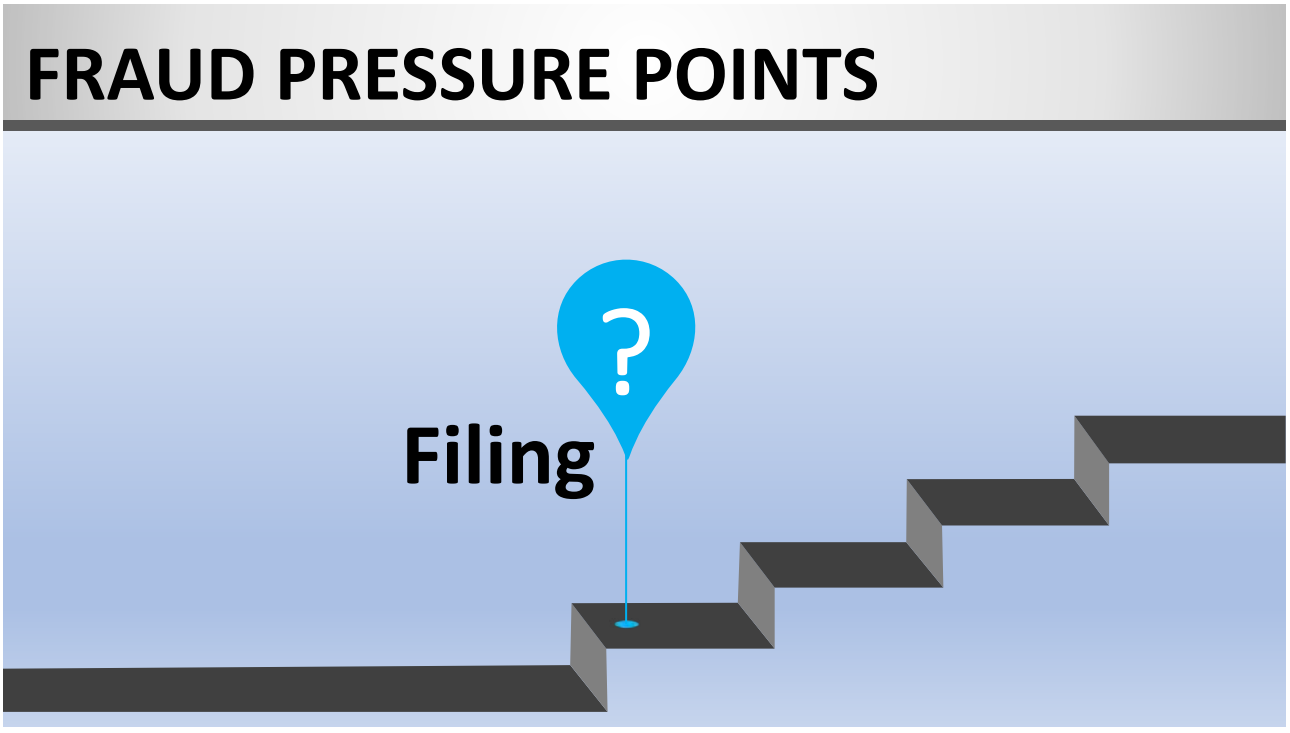
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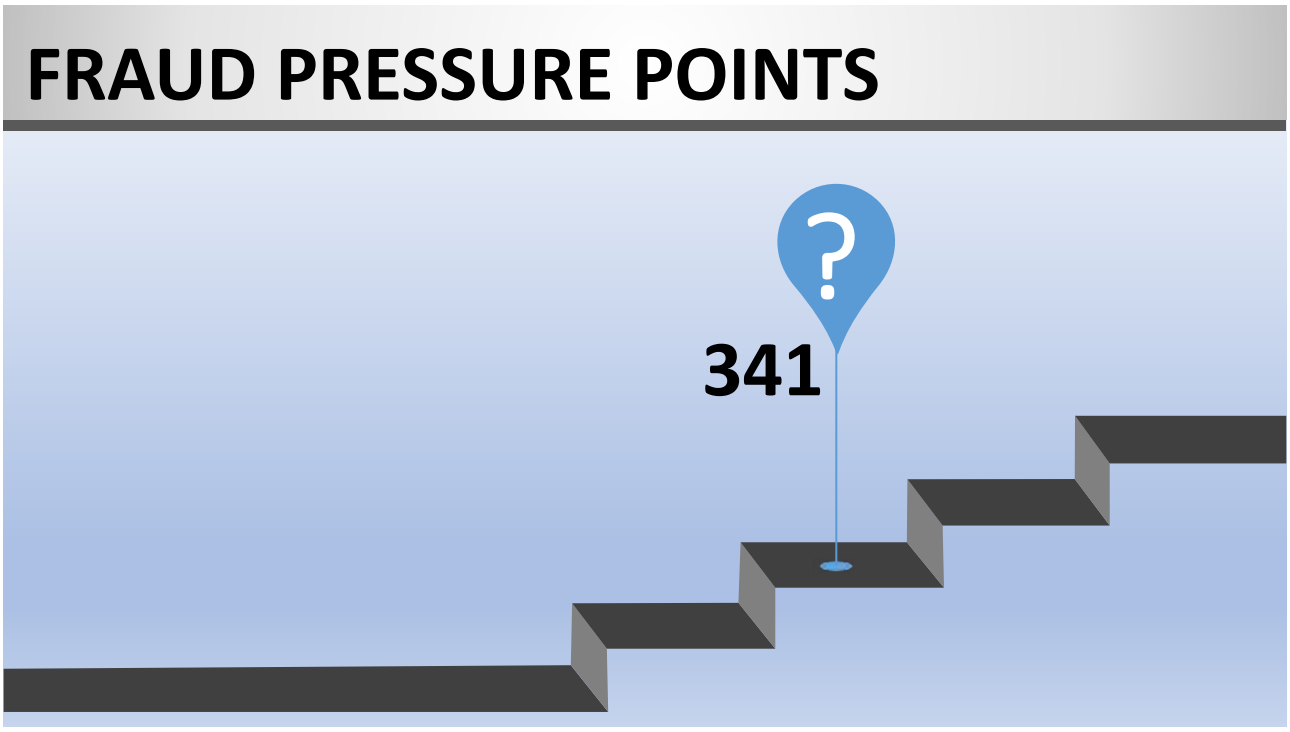
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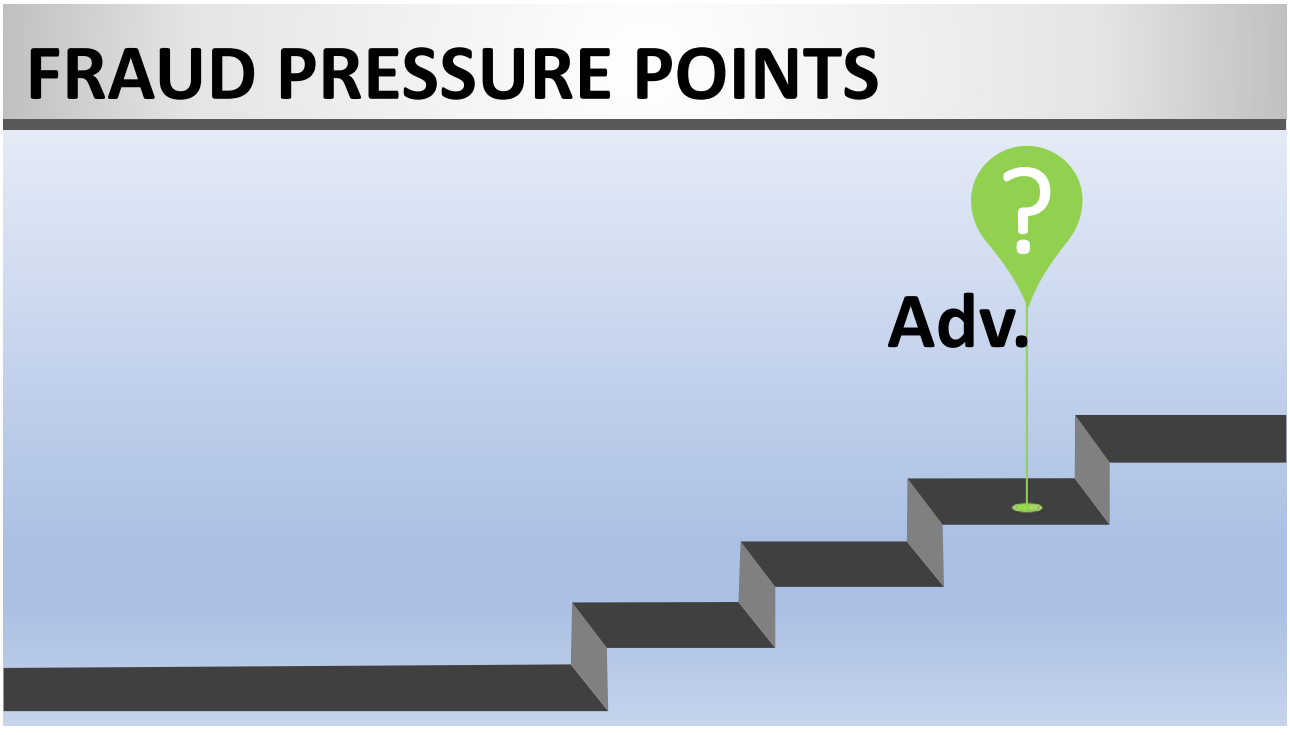
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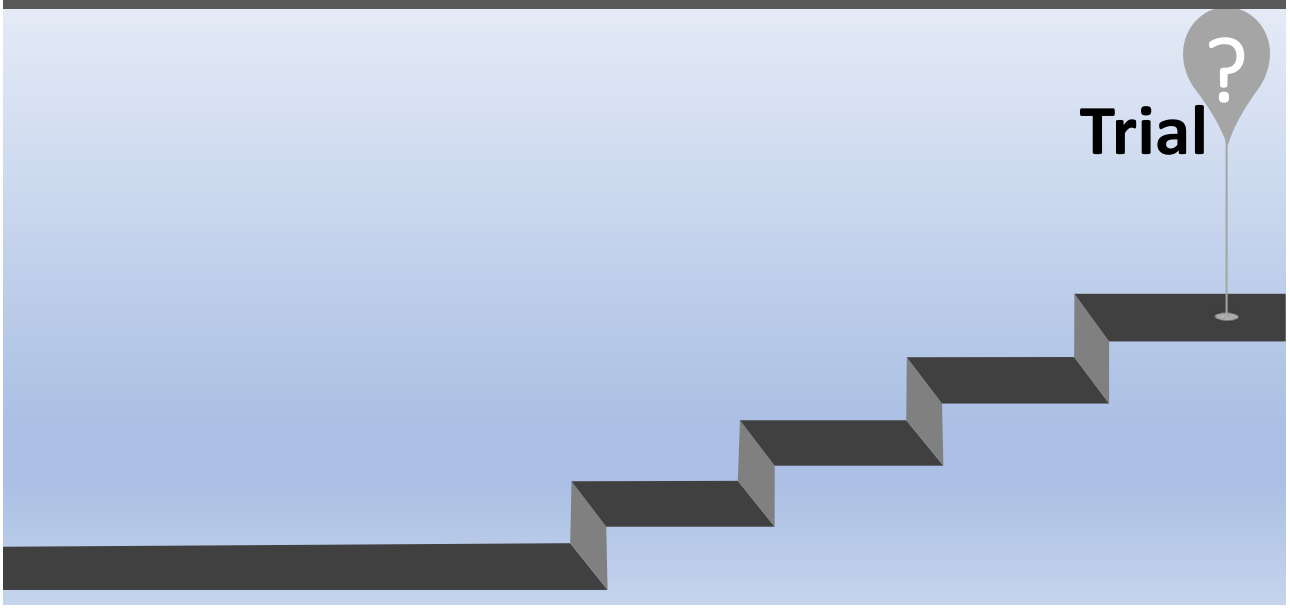

Litigating Fraud in Consumer Cases

By: Hon. Cynthia A. Norton[1]
U.S. Bankruptcy Judge, W.D. MO
Presented to the ABI Winter Leadership Conference
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Contents

[1] Materials compiled and prepared by Jacorius Williams, Term Law Clerk to Judge Cynthia A. Norton, with editing assistance from Erica Garrett, Career Law Clerk to Judge Cynthia A. Norton.

Introduction

The United States Bankruptcy Code offers debtors the opportunity to obtain a fresh start. Congress gives "honest but unfortunate debtor[s] the chance to repay their debts,"[2] but such discharge often excludes debts incurred by fraud and a discharge may be denied altogether if the fraud extends beyond just one creditor.

The discharge and dischargeability of debts are uniquely questions of federal bankruptcy law.[3] Litigating fraud in consumer bankruptcy cases requires one to have an understanding of the following code provisions, among others: 11 U.S.C. §§ 523, 524, 727, 1141, 1228 and 1328. Such litigation also requires knowledge of the Federal Rules of Civil Procedure as they are incorporated into the Federal Rules of Bankruptcy Procedure and applicable local rules.

Debts excepted from discharge under § 523 are nondischargeable as to a particular creditor,[4] and offenses under § 727 that go to the heart and integrity of the bankruptcy system may result in the denial of discharge altogether.[5]

I. 11 U.S.C. §§ 523 and 727

a) 11 U.S.C. § 523 – Debts non-dischargeable as to a particular creditor

The grounds for denial of discharge of a particular creditor's debt for fraudulent or fraud-like conduct typically require the objecting party to prove that the debtor engaged in one or more of the following types of conduct:

- The debt was obtained through false pretenses, false representations or fraud, including false financial statements (11 U.S.C. § 523(a)(2));
- Fraud while acting in a fiduciary capacity, embezzlement or larceny (11 U.S.C. § 523(a)(4)); or
- Willful and malicious injury to another's person or property (11 U.S.C. § 523(a)(6)).

b) 11 U.S.C. § 727 – No debts are discharged based on the debtor's conduct

The grounds for a denial of the general discharge of all debts include, among other things, the following types of conduct:

- Transferring, destroying or concealing property of the estate within one year before the filing of the petition or after filing of the petition with intent to hinder, delay or defraud a creditor or an officer of the bankruptcy estate (11 U.S.C. § 727(a)(2));
- Concealing, destroying, falsifying, or failing to preserve information, books, and records about the debtor's financial condition and/or business transactions (11 U.S.C. § 727(a)(3));

[2] *Marrama v. Citizens Bank of Massachusetts*, 127 S. Ct. 1105, 1111 (2007) (citing *Grogan v. Garner*, 111 S. Ct. 654, 755 (1991)).
[3] *Grogan v. Garner,* 111 S. Ct. 654, 656 (1991).
[4] 11 U.S.C. § 523.
[5] 11 U.S.C. § 727.

- Knowingly or fraudulently making false oath in connection with the case (11 U.S.C. § 727(a)(4));
- Failing to explain satisfactorily any loss of assets (11 U.S.C. § 727(a)(5)); or Refusing to obey lawful orders of the court and/or respond to material questions or to testify (11 U.S.C. § 727(a)(6)).

II. What constitutes fraud?

In ***Husky Int'l Electronics, Inc. v. Ritz*, 136 S. Ct. 1581 (2016),** the United States Supreme Court addressed whether the term "actual fraud" as used in 11 U.S.C. § 523(a)(2)(A) applies where an individual debtor deliberately obtains money through a fraudulent-transfer scheme that was actually intended to cheat a creditor or, instead, whether "actual fraud" requires the debtor to have made a false representation to the creditor. Writing for the majority, Justice Sotomayor concluded that the term "actual fraud" in § 523(a)(2)(A) encompasses various forms of fraud, like fraudulent conveyance schemes, that can be effected without a fraudulent representation.

The Court explained that the historical meaning of "actual fraud" provides even stronger evidence that the phrase has long encompassed conduct such as a transfer scheme designed to hinder the collection of debt, and common-law fraud is broad enough to incorporate a fraudulent conveyance without any accompanying misrepresentation from a debtor to a creditor. The fraudulent conduct involved in a fraudulent conveyance does not require dishonestly inducing a creditor to extend credit but, rather, can occur in the acts of concealment and hindrance. The Court's interpretation of "actual fraud" preserved meaningful distinctions between § 523(a)(2)(A) and other subsections of § 523, and, given the differences between those provisions, the Court saw no reason to create an artificial definition of "actual fraud" to avoid redundancies in § 523 that appear unavoidable.

III. Can liability be imputed to a partner for debt created by another partner's fraud?

In ***Bartenwerfer v. Buckley*, 143 S. Ct. 665 (2023)**, the United States Supreme Court held that debts created by a partner's fraud are nondischargeable against an innocent partner, even if the innocent party did not know or have reason to know of the partner's fraud. In so holding, the Court rejected the standard established by the Eighth Circuit in *In re Walker*, 726 F.2d 452 (8th Cir. 1984). Writing for the majority, Justice Barrett found the result justified by the use of the passive voice in § 523(a)(2)(A) (a debt is nondischargeable "to the extent obtained by . . . actual fraud") and the Court's prior holding in *Strang v. Bradner*, 5 S. Ct. 1038 (1885).

The Bartenwerfers, as undisputed "business partners" under applicable California law, purchased real estate for the purpose of renovating and flipping it. Mr. Bartenwerfer, who had no construction experience, handled the improvements himself. In the disclosures made to the buyer, Mr. Buckley, the Bartenwerfers did not disclose numerous problems with the building, including leaky windows, open permits, etc. Buckley sued the Bartenwerfers for damages for fraud and, after a 19-day state court jury trial, won a $200,000+ verdict against the Bartenwerfers. They filed chapter 7 bankruptcy and Buckley filed a complaint seeking to except the debt from discharge for fraud under § 523(a)(2)(A). The bankruptcy court, after trial, initially imputed Mr. Bartnerwerfer's fraud to Mrs. Bartenwerfer and found the debt nondischargeable. The Bartenwerfers appealed.

The Ninth Circuit Bankruptcy Appellate Panel reversed and remanded, finding that the bankruptcy court erred in not applying a similar standard to that of the Eighth Circuit's *In re Walker* case (namely - that to be nondischargeable, Mrs. Bartenwerfer must have known or should have known of her husband's fraud). On remand, the bankruptcy court found Mrs. Bartenwerfer did not know and had no reason to know of her husband's fraud and found the debt dischargeable. Buckley appealed and the BAP affirmed, but the Ninth Circuit reversed, holding that no culpability standard was required to find the debt nondischargeable.

In a concurrence by Justice Sotomayor, which Justice Jackson joined, Justice Sotomayor emphasized that the Supreme Court had long ago confirmed that fraudulent debts obtained by partners are not dischargeable, noting that the Court was not confronting a situation involving fraud by a person bearing no agency or partnership relationship to the debtor. She joined the Court's opinion with the "understanding" that imputation concerns fraud only by "agents" and "partners within the scope of the partnership."

IV. Additional United States Supreme Court precedent regarding 11 U.S.C. § 523[6]

- Nondischargeability of priority taxes under § 523(a)(1)(A):
  → *Young v.* United States, 122 S. Ct. 1036 (2002) (3-year look back provided by § 507(a)(8)(A)(i) is tolled during debtors' prior chapter 13)

- Extent of nondischargeable debt "arising from" the fraud under § 523(a)(2)(A):
  → *Cohen v. de la Cruz*, 118 S. Ct. 1212 (1998) (both compensatory and punitive damages, including obligation to pay treble damages and attorneys' fees, held to be excepted from discharge for actual fraud under § 523(a)(2)(A))

- Fraud and the element of reliance under § 523(a)(2)(A):
  → *Field v. Mans*, 116 S. Ct. 437 (1995) (fraud exception to discharge requires justifiable reasonable reliance) (NOTE: compare §523(a)(2)(B)(iii) – reliance on false written statements regarding financial condition must be "reasonable" – *see Lamar, Archer & Cofrin, LLP v. Appling,* 138 S. Ct. 1752 (2018), below)

- What constitutes a statement respecting the debtor's financial condition under § 523(a)(2)(B):
  → *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752 (2018) (a statement about a single asset can be a "statement respecting the debtor's financial condition" within fraud exception to discharge; false financial statement exception requires reasonable reliance, in contrast to false pretenses, false representation, or actual fraud exception under § 523(a)(2)9A) requires the lesser showing of justifiable reliance)

- What constitutes a breach of fiduciary duty under § 523(a)(4):
  → *Davis v. Aetna Acceptance Co*., 55 S. Ct. 151 (1934) (fiduciary duty must arise out of an "express, technical trust")

- What constitutes a defalcation under § 523(a)(4):

[6] From *Supreme Court Dischargeability Cheat Sheet,* prepared by the Honorable Judge Cynthia A. Norton, W.D. Mo., for the SBLI Discharge Presentation, May 6, 2021 (Derived from the 2021 edition of the *Mini-Code*, published by AWHFY, L.P.).

→ *Bullock v. BankChampaign, N.A.,* 133 S. Ct. 1754 (2013) (defalcation requires a culpable state of mind)

- Willful and malicious injury under 523(a)(6):
  → *Kawaauhau v. Geiger*, 118 S. Ct. 974 (1998) (debt arising from medical malpractice held dischargeable when conduct was negligent or reckless, which did not meet the standard for "willful and malicious" under § 523(a)(6); actual intent to cause injury is required)

- Nondischargeability of criminal restitution under §§ 523(a)(7) & 1328:
  → *Kelly v. Robinson*, 107 S. Ct. 353 (1998) (dischargeability of criminal restitution in chapter 7 – 523(a)(7))

- No sovereign immunity defense in student loan undue hardship adversary under § 523(a)(8):
  → *Tennessee Student Assistance Corp. v. Hood*, 124 S. Ct. 1905 (2004) (state's sovereign immunity did not protect it from student loan debtor's hardship discharge adversary; jurisdiction was in rem and was not a suit against the state under the 11th Amendment)

V. Litigating a fraud case

a) Pre-filing strategies[7]

Client intake is often the first step in the bankruptcy filing process. It provides an opportunity for the attorney to parse out any potential obstacles to discharge; therefore, it is vital to know how to handle intake, as debtors may be overwhelmed and have lots of questions as they provide their sensitive information.[8] Consider the following during the intake process:

- Interview the client thoroughly; take good notes. Identify the real party in interest to ensure that they have standing to bring the action.

- Ask the client who else has knowledge of the events and who might be a good witness to issues which may arise in the case.

- Immediately determine if there is a statute of limitations for filing the complaint and calendar it, along with several pre-deadline reminders (*e.g.*, calendar "statute of limitations in Johnson case expires on 4/15 – 90 days to go"). Err on the side of caution in calculating the statute of limitations (*e.g.*, if a one-year statute begins running on Jan. 17, don't calendar Jan. 17 of the next year – the deadline may be Jan. 16, or earlier, depending on how the days are counted).

- Gather all pertinent documents and keep them in one place; make copies of the original documents (so you can make notes on them if you need to) and safeguard

[7] From *Thoughts on Trial Preparation Strategies For Consumer Bankruptcy Lawyers,* prepared by the Honorable Judge Cynthia A. Norton, W.D. Mo., Jan. 19, 2017.

[8] *See* Meredith Boe, *NextChapter: Conducting Bankruptcy Client Intake*, Sep. 16, 2020 https://blog.nextchapterbk.com/posts/bankruptcy-client-intake#:~:text=Client%20intake%20is%20one%20of%20the%20first%20steps,you%20need%20to%20know%20about%20bankruptcy%20client%20intake.

the originals in a secure location (such as the firm's safe deposit box) so they aren't lost or defaced before trial. Make sure not to rearrange original documents given to you by the client, such as a file folder. If what is in a file folder and/or the order the documents are in may be important, then make a copy and bate-stamp the pages so you have a record.

- Remember to ask for relevant electronic documents, such as calendars, emails, cell phone records, etc., and remind the client of the duty not to erase, discard, throw away, etc., anything relating to the litigation (explain spoliation and sanctions) until you advise it is safe to do so. Remind the client to let you know immediately if they find other documents that may be pertinent.
- Make an initial timeline of the pertinent facts and events with specific references to where in the file/record you obtained the date/event.
- Ask the client who they have talked to about the case or given a statement to and, if they have given such a statement, obtain a record of it. Remind the client that he or she should not talk to other people about the case or what you have advised the client, as such disclosure to third parties may waive the attorney-client privilege.
- Ask the client specifically what their goals for the litigation may be. Make your understanding of the goal clear to the client and make sure the goal is something you can legally and ethically accomplish.
- Consider whether there may be other related causes of action and discuss with the client the advantages and disadvantages of including those. For example, do you really need the Fair Debt Collection Practices Act and the Fair Credit Reporting Act counts if you have a strong discharge injunction violation?
- Consider whether you want a jury trial.
- Decide what court is appropriate to bring the action in. Ask yourself: does this court have the authority to do what I want it to do?
- Research the relevant law to make sure you know all the elements so that you can tailor your factual allegations to make sure all relevant elements have been pled.
- Make sure you understand the nature of the remedies you are seeking (injunctive relief, declaratory relief, money judgment, attorneys fees, indemnity, prejudgment interest, etc.).
- Review Fed. R. Bankr. P. 7008, 7009, and 7010, and any local rules implementing pleading requirements pursuant to Fed. R. Civ. P. 8.
- Manage the client's expectations by having an engagement letter that clearly specifies, among other things: the scope of the engagement (*e.g.,* does the engagement include appeals?); how the attorney fees and costs will be dealt with; what decisions you are authorized to make on the client's behalf (*e.g.*, explain that you have the authority to consent to requests for extensions, whether to depose a witness, what witnesses or evidence to adduce at trial, etc.); that you cannot

guarantee a particular result; that the client has the duty to respond timely to discovery requests from the other side and to court orders.

- If ethically required and otherwise appropriate, send a demand letter to the opposing side. Sometimes it is better to make a phone call to the opposing side because the possibility of a settlement may arise.
- Draft the complaint and send it to the client for review and approval before you file it; consider whether the complaint should be verified by the client.
- Double-check the name and organization type of the defendant(s).
- Double-check Fed. R. Bankr. P. 7004 to make sure you know how to obtain good service over the defendant(s).
- As a gut check, ask your client what he or she thinks about what the defendant will say in response to the complaint – sometimes surprising things the client "forgot" to tell you pop out at this stage.
- As a final gut check, ask again how you/your client are going to be able to prove what the complaint alleges.

Remember that diligently preparing schedules, the statement of financial affairs, and forecasting potential fraud issues can leave the trustee and creditors with little to no reason to bring an adversary proceeding.[9]

Also remember that debtors may take some steps to protect their assets prior to filing for a bankruptcy by converting nonexempt assets to exempt assets.[10] However, asset protection strategies can have their pitfalls as well, as illustrated by the following examples:

In ***In re Arregui*, No. 22-40516-BTF, 2023 WL 6205616 (Bankr. W.D. Mo. Sept. 22, 2023) (slip copy),** the court addressed whether employing asset protection strategies to increase the debtors' exemptions in their residence constituted fraud. The debtors purchased their residence in 1999 and held title as joint tenants with the right of survivorship. The debtors married in 2007. Years later, on April 29, 2022, the debtors filed a quit claim deed transferring title to the residence from themselves as single persons to themselves as husband and wife. The next business day, on May 1, 2022, the debtors commenced their chapter 13 case. The trustee filed an adversary proceeding, seeking to avoid the debtors' transfer of the residence and recover the joint tenancy for the estate. The debtors claimed that they transferred the property from themselves as joint tenants to themselves as tenants by the entireties on advice of counsel, and chose not to disclose the transfer because they did not believe the change in ownership qualified as a transfer.

Where a debtor's transformation of nonexempt assets to exempt assets satisfies several badges of fraud or statutory factors, the Eighth Circuit also requires evidence of fraud extrinsic to the mere facts of conversion of non-exempt assets into exempt. The court determined that

[9] *See* Law Office of Seni Popat, PC., *Adversary proceedings in bankruptcy: What to do when you're sued*, Dec. 2, 2020, https://www.splawpc.com/blog/2020/december/adversary-proceedings-in-bankruptcy-what-to-do-w/.
[10] Ken LaMance, *LegalMatch: Pre-Bankruptcy Planning*, Dec. 16, 2021, Pre-Bankruptcy Planning Process | LegalMatch.

three circumstances provided extrinsic evidence of fraud. First, the debtors continued to retain, benefit from, and used their property after the transfer. Second, the debtors transferred the property in very close proximity to the petition date—within one business day. Third, and most egregiously, despite transferring the property in such close proximity to the petition date, the debtors appeared to have deliberately omitted the transfer from their statement of financial affairs. The omission was inexcusable and might alone have been sufficient to establish that the debtors acted with fraudulent intent. The court held that the debtors' transfer was actually fraudulent under the Bankruptcy Code and the Missouri Uniform Fraudulent Transfer Act and, therefore the transfer should be avoided, and the debtors' joint tenancy ownership should be recovered and reinstated for the benefit of the chapter 13 estate.

b) Filing the bankruptcy petition

Remember when filing a bankruptcy petition that the meeting of creditors pursuant to 11 U.S.C. § 341 is an important consideration for litigating fraud. There are common red flags that a trustee will ask about at the meeting of creditors, such as: undisclosed or undervalued property, unverified income, excessive expenses, recent creditor payments, and recent property transfers.[11] This is also an opportunity for creditors to get answers to threshold questions prior to filing a dischargeability compliant.

Moreover, the meeting of creditors is critically important because it determines the deadline for filing of dischargeability complaints under Fed. R. Bankr. P. 4004. The deadline for the trustee or creditors to challenge either the overall discharge or the dischargeability of a particular debt is sixty days after the date first set for the meeting of creditors, regardless of whether the meeting is concluded.

In ***Kontrick v. Ryan*, 124 S. Ct. 906 (2004),** the United States Supreme Court held that the 60–day time limit for filing objections to a debtor's discharge set forth in Fed. R. Bankr. P. 4004(a) is not jurisdictional. A creditor, in an untimely pleading, objected to the debtor's discharge. However, the debtor did not promptly move to dismiss the creditor's objection as impermissibly late. Only after the bankruptcy court sustained the creditor's objection did the debtor raise the issue. Time bars generally must be raised in an answer or responsive pleading. An answer may be amended to include an inadvertently omitted affirmative defense, and, even after the time to amend has passed, leave to amend is to be freely given. The debtor failed to assert the time constraints of the Rules in a pleading or amended pleading. He moved to delete certain items from the respondent's summary judgment filings, but, even that far into the litigation, he did not ask the bankruptcy court to strike the claim at issue. The Supreme Court agreed with the lower courts and held that if the debtor does not raise the Rule's time limitation before the bankruptcy court reaches the merits of the creditor's objection to the discharge, then debtor forfeits the right to rely on Fed. R. Bankr. P. 4004.

[11] Cara O'Neill, *Nolo: Red Flags the Bankruptcy Trustee Looks for at the Meeting of Creditors*, https://www.alllaw.com/articles/nolo/bankruptcy/red-flags-trustee-meeting-creditors.html.

c) *Before an adversary complaint has been filed* [12]

- Consider how much time you need for discovery, whether you will be filing a dispositive motion, what a deadline for amendments should be, what a deadline for designating experts should be, and discuss these with opposing counsel.
- Take the time to write a trial brief at the start of your trial preparation. It will cause you to focus on the facts you need to prove and what the law is (and a well-written succinct trial brief will really assist the judge). It will also help you compile the exhibits in the order they will naturally come into evidence.
- Be prepared at all status conferences with the Court. Have your (and your client's) calendar up and ready in case court dates or deadlines need to be set or re-set.

d) *An adversary complaint has been filed*[13]

- If you haven't already, make a trial notebook. It will eventually include the complaint, the answer, the pretrial order, witness outlines, exhibit list, pertinent case law, etc.
- Send a copy of the filed complaint to the client and ask the client to review and let you know if there is anything that needs to be amended.
- Request the alias summons and calendar 7 days to serve along with the dates in the pretrial order you receive from the court.
- Calendar other pertinent procedural dates: 21 days to amend once the complaint is served without leave of court (Fed. R. Civ. P. 15, made applicable in bankruptcy cases by Fed. R. Bankr. P. 7015); 30 days for the answer date (Fed. R. Bankr. P. 7012(a)); 90 days to achieve service (Fed. R. Civ. P. 4(m), made applicable in bankruptcy cases by Fed. R. Bankr. P. 7004).
- Map out discovery strategy; discuss the strategy with the client for their "buy-in" (not consent, because the client doesn't have to consent); calendar potential dates.
- Once the court has set deadlines, then calendar all dates, starting with the trial date and working backwards, e.g., 30 days until trial – start witness prep; 20 days until trial – subpoena witnesses; 60 days to discovery cut off – send interrogatories; 30 days until dispositive motions – start summary judgment motion, etc.
- Send all the dates to your client and the witnesses you intend to call well in advance!

e) *Defense strategies*[14]

You must prepare as though the trial will occur even if you hope to settle. Trial preparation should be prospective, which involves a different skill set from being a flat fee

[12] From *Thoughts on Trial Preparation Strategies For Consumer Bankruptcy Lawyers,* prepared by the Honorable Judge Cynthia A. Norton, W.D. Mo., Jan. 19, 2017.
[13] From *Thoughts on Trial Preparation Strategies For Consumer Bankruptcy Lawyers,* prepared by the Honorable Judge Cynthia A. Norton, W.D. Mo., Jan. 19, 2017.
[14] Randy Nussbaum, *Consumer Practice Extravaganza: Defending a 523/727 Action*, A.B.I. (2021), https://www.abi.org/education-events/sessions/defending-a-523727-action.

consumer lawyer.[15] If an adversary complaint is filed, a separate fee agreement supported with a separate retainer should be filed as well, due to the additional services and costs that the lawsuits will present.[16] Possible strategies include:

- Slow-playing the defense – allows you to minimize the actual day-by-day work that has to be done. This gives the client time to raise money to ultimately try the case. However, be sure not to blow any deadlines or prejudice the client in the process. Occasionally, opposing counsel will lose interest over time and the strategy can result in a settlement – unless the risk to opposing counsel's investment is minimal.

- Traditional defense – you proceed in a rational and methodical fashion. You prepare and file appropriate motions and engage in traditional discovery, while trying to stretch the work out over time for budgeting purposes. This strategy may bring about expenses quickly so that settlement becomes no longer realistic.

- Aggressive defense – this strategy is highly effective where opposing counsel is not likely to back down unless forced to do so and the client can afford it. The downside of this approach is the cost and the realization that if the case doesn't settle very quickly, settling becomes infeasible because of the investment by both sides.

f) Discovery deadlines, rules of procedure, and rules of evidence

Bankruptcy litigation is different from "normal" litigation. While the bankruptcy discovery process has some similarities with federal and state litigation, you must be aware of the nuances of bankruptcy litigation. It may also pay off to take informal discovery before opting for formal discovery.[17] Consider the following examples:

- A court may exclude the undisclosed witnesses from testifying unless defendants demonstrate that their failure was substantially justified or harmless. See Fed. R. Civ. P. 37, made applicable in bankruptcy cases by Fed. R. Bankr. P. 7037. Defendants' failure was not substantially justified because they knew the witnesses were relevant to their defense well before the close of discovery. Yet they failed to identify them. Case management deficiencies or a lack of due diligence does not constitute substantial justification. *See Pineda v. City & County of San Francisco*, 280 F.R.D. 517, 521 (N.D. Cal. 2012).

- A party that fails to comply with Rule 26's disclosure deadline must demonstrate that its failure was substantially justified or harmless. See Fed. R. Civ. P. 37, made applicable in bankruptcy cases by Fed. R. Bankr. P. 7037; *Yeti by Molly, Ltd. v. Deckers Outdoor Corp.,* 259 F.3d 1101, 1106 (9th Cir. 2001) (burden of proof is on the non-compliant party).

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[15] Randy Nussbaum, *Consumer Practice Extravaganza: Defending a 523/727 Action*, A.B.I. (2021), https://www.abi.org/education-events/sessions/defending-a-523727-action.

[16] Randy Nussbaum, *Consumer Practice Extravaganza: Defending a 523/727 Action*, A.B.I. (2021), https://www.abi.org/education-events/sessions/defending-a-523727-action.

[17] Jeffrey Fuller, *Analysis: Six Tips for Navigating Bankruptcy Discovery*, Feb. 1, 2023, https://www.bloomberglaw.com/bloomberglawnews/bloomberg-law-analysis/X9935HP0000000?bna_news_filter=bloomberg-law-analysis#jcite.

- A party establishes "substantial justification" for their failure to comply with the disclosure requirements of Rule 26 by demonstrating that a genuine dispute exists concerning compliance or that the failure was attributable to reasons that were outside the control of the non-complaint party. *See Travelers Indem. Co. of Conn. v. Walking U Ranch*, LLC, No. 2:18cv02482-CAS-GJS, 2022 WL 1601388, *2 (C.D. Cal. Jan. 11, 2022); *Liew v. Breen*, 640 F.2d 1046, 1050 (9th Cir. 1981) (addressing conduct under Rule 37(b), a good faith dispute concerning a discovery question might constitute "substantial justification"); *see also Pineda*, 280 F.R.D. at 521.

- A plaintiff's general knowledge of a witness does not excuse a defendant from the requirements of Rule 26 and does not establish the harmless exception. *See, e.g., Enertrode, Inc. v. General Capacitor Co.,* No. 16-cv-02458-HSG, 2018 WL 5879810, *2 (N.D. Cal. Nov. 7, 2018).

- The harmless exception covers situations such as "inadvertent omission from a Rule 26(a)(1)(A) disclosure of the name of a potential witness known to all parties; the failure to list as a trial witness a person so listed by another party; or the lack of knowledge of a pro se litigant of the requirement to make disclosures." *Green v. Baca*, 226 F.R.D. 624, 655 (C.D. Cal. 2005) (Fed. R. Civ. P. 37, made applicable in bankruptcy cases by Fed. R. Bankr. P. 7037).

g) General observations regarding litigation preparation[18]

- Trial preparation should be prospective, which involves a different skill set from being a flat fee consumer lawyer.

- Deadlines are important in litigation. Blown discovery deadlines may result in sanctions. Rules of Procedure are important in litigation. Rules of Evidence are doubly important in litigation.

- Make sure your client and all your friendly witnesses know in advance (and in plenty of time) when the trial will be and that you will want time to prepare with them.

- Consider whether you need to subpoena hostile witnesses.

- Consider whether to file motions in limine (such as to address an evidence issue in advance).

- Consider bringing a nervous client to the courtroom in advance: Ask the courtroom deputy to open the courtroom for you, and show the client where he or she will sit, get sworn, and testify. Be sure to tell the client what to wear, how to act (no grimacing or making faces at the opposing side), to remember to bring photo identification, etc.

- If using courtroom technology, make a trial run to make sure everything works.

[18] From *Thoughts on Trial Preparation Strategies For Consumer Bankruptcy Lawyers,* prepared by the Honorable Judge Cynthia A. Norton, W.D. Mo., Jan. 19, 2017.

- Prepare a witness outline that tells the story, incorporates your exhibits, and contains the elements necessary to lay the foundation for each exhibit (even if you anticipate stipulating to them by the date of trial).
- Prepare a separate outline of potential cross-examination points for each witness and important exhibit; include references to the Federal Rules of Evidence you anticipate using to challenge a witness or exhibit.
- Put the exhibits in a notebook marked on each page. (In Adobe Professional, use the footer function which has a built in numbering mechanism, *e.g.*, Exh. A p.1 of 8.) Remember to have an original exhibit notebook for the witness for the record, in addition to one for you, the judge, perhaps the law clerk, and the client to follow along with.
- NOTE: Since exhibit tabs and notebooks are expensive, scavenge them from other matters and save them to reuse.
- Draft a short opening: What the case is about; how many witnesses you intend to call and briefly what they will testify about; what relief you will be asking for.
- If appropriate, draft a closing.
- Rehearse, rehearse, rehearse, but don't drink the Kool-Aid so much that you don't focus on what the other side's case is going to be and how you are going to defeat it.
- At this point, you will be prepared, so you can tell yourself: "I'm just going to go have fun!"

VI. Trial

The burden of proof plays a vital role in the success of a dischargeability suit. The burden of proof determines how much evidence is required to achieve success.

In ***Grogan v. Garner*, 111 S. Ct. 654 (1991),** the United States Supreme Court held that the burden of proof for the dischargeability exception litigation is ordinarily the preponderance of the evidence standard. The party alleging nondischargeability bears the burden of proof.

a) Exhibit Checklist[19]

- **Identifying Which Exhibits You Will Need.** Figuring out what evidence you will need to prove your case should not start the week before the trial or hearing – it starts at the beginning of the case with a well-thought-out, well-drafted pleading (motion, objection, complaint, answer, etc.). And to have a well-drafted pleading, you need to know the elements of what you need to prove or disprove to determine which exhibits you need. As you get closer to trial, you can refine your thoughts by drafting a trial brief with proposed findings of fact as part of your initial trial preparation. The process of telling the story in writing can help focus your attention on which exhibits you need to prove

[19] Prepared by the Honorable Chief Judge James P. Smith and the Honorable Judge Cynthia A. Norton: Exhibit Checklist/Cheat Sheet.

which elements. If you forget an element and corresponding exhibit or other evidence needed to prove it and remember it only at trial, the judge may not let it your evidence or exhibit in, particularly if the opposing counsel objects.

- **Organization of Exhibits**. It makes the most sense to put the exhibits in the order in which they will be introduced. Possible ways to organize: chronologically; by element; or by witness. Grouping the exhibits in this way will make it easier for you to find them quickly, and for the witness and the judge to follow the story you are trying to tell.

- **Pre-Marking.** Mark all exhibits *before* the hearing – it wastes valuable court time to mark the exhibits on the fly (and some courts require pre-marking by local rule).

- **Letters or Numbers.** Determine if your court/judge has a local rule about which party marks exhibits with letters (*e.g*., Exhibit A, Exhibit B, etc.) and which with numbers (*e.g*., Exhibit 1, Exhibit 2, etc.). If in doubt, call the courtroom deputy and/or discuss with opposing counsel or the judge.

- **Page Numbers:** It is particularly helpful, especially with multi-page exhibits, to mark each page, *e.g*, Exhibit 1, P. 1 of 10, Exhibit 1, P. 2 of 10, and so on. That makes it easier for you, the witness, and the judge to find a particular page of a particular exhibit quickly. You can do this easily by scanning or converting the exhibit to an Adobe PDF and using the tools in Adobe Professional to add a footer to each page. It is also helpful (and many courts require) additional information, such as the party's name and case number, *e.g*.:
  → ***In re Smith*, Case No. 10-12345**
  → **Debtor's Exh. 1, p. 1 of 10**

- **Redaction of Certain Information.** Remember that 11 U.S.C. § 107 and Fed. R. Bankr. P. 9018 require redaction of certain identifying information, such as the names of minor children, social security numbers, account numbers, etc. Discuss with the judge in advance how to handle this issue if the particular case requires for some reason evidence of what the social security number is.

- **Binders & Tabs.** Put the exhibits in a binder with tabs with a copy of the exhibit index in the front. This is particularly important if the exhibits are voluminous (and many courts require exhibit binders in any event). NOTE: You can save money by reusing and recycling exhibit binders and tabs as they can be costly.

- **Electronic or Other Nondocumentary Exhibits.** Discuss with the judge, courtroom deputy, and opposing counsel in advance how the marking, sharing, and introduction of electronic or other nondocumentary evidence such as audio recordings should be handled. Be sure to arrange a trial run in the courtroom with the assistance of the courtroom deputy to make sure, for example, your audio recording can be played and heard.

- **Copies.** In addition to the original exhibits for the witness (which will become part of the record and retained by the court if necessary), remember to bring sufficient copies of the original for all counsel and a copy for the judge. It is an appreciated gesture to also bring a copy for the law clerk.

- **Stipulations for Admission.** Many of the typical exhibits used in bankruptcy cases should not be disputed (e.g., loan documents). Share exhibits with opposing counsel ahead of time to try to agree on what documents can be admitted without objection – at least as to foundation. You risk irritating the judge and again wasting valuable court time if you do not have an agreement to admit exhibits that are not in dispute.

- **Foundation.** Be sure to have thought out in advance how to lay a foundation for admission and obtaining a ruling on admission for each exhibit you want to introduce. Lay that foundation and request the judge to admit the exhibit *before* you begin soliciting testimony from the witness about that exhibit. If you are unsure of how to lay a foundation for a particular exhibit, consult one of the many resources on how to admit evidence, such as *Evidentiary Foundations* by Edward Imwinkelreid, or any of the helpful publications for trial organizations such as the National Institute for Trial Advocacy, and write out in your witness outline each element of the foundation so that you don't forget one.

- **Lay Foundation First as the Examining Attorney; As the Opposing Attorney, Timely Object if the Examining Attorney Doesn't.** Many attorneys jump right into asking the witness to testify about the document or even asking the witness to read the document before laying the foundation and having it admitted. Later, when the attorney moves to introduce the exhibit, the opposing attorney objects for lack of foundation, which is then sustained. The problem for the opposing attorney who failed to object when the witness first started testifying about the unadmitted document is that the judge has already heard testimony about the contents – that bell cannot be unrung. But it may also be a problem for the attorney who failed to lay the proper foundation – the judge has the authority under Fed. R. Evid. 403 to deny that attorney the opportunity to try again if doing so would be a waste of time.

- **And Don't Forget to Bring a Copy of the Federal Rule of Evidence.**

Conclusion

When handled carefully, a properly planned bankruptcy filing can significantly reduce the likelihood of an adversary complaint being filed. When not handled carefully, you may do harm to your clients, which in turn may roll downhill to you – creating the path for a malpractice or an ethics complaint.

Addendum to
Litigating Fraud in Consumer Cases
U.S. Bankruptcy Judge Cynthia A. Norton, W.D. MO[1]

Nondischargeability

A debt proven under state law on grounds other than fraud may be excepted from discharge under the "actual fraud" provision of the discharge exception for false pretenses, a false representation, or actual fraud. *In re Thompson*, 555 B.R. 1 (B.A.P. 10th Cir. 2016)

A judgment creditor, after obtaining a $1 million state-court default judgment against the debtor's LLC based on substandard care allegedly provided to the judgment creditor's late wife at a nursing home owned by the debtor's LLC, filed an adversary complaint asserting that the debtor was personally liable for the judgment under a corporate veil-piercing theory and that the debtor's alleged personal liability was nondischargeable. The Bankruptcy Appellate Panel for the Tenth Circuit reversed and remanded the matter on appeal after the bankruptcy court granted summary judgment in favor of the debtor. The court held that a debt proven under state law on grounds other than fraud may be excepted from discharge under the "actual fraud" provision of the discharge exception for false pretenses, a false representation, or actual fraud. The court's reasoning was that in determining the nondischargeability of the debt under § 523(a)(2)(A) based on actual fraud, there is no requirement that a creditor rely on the actual fraud or part with assets or receive credit at the inception of, or concurrently with, the actual fraud. Nor is there a requirement that the debtor's actual fraud induced the creditor to part with property or extend credit, and because genuine issues of material fact remain with respect to the elements of the judgement creditor's claim under § 523(a)(2)(A) an entry of summary judgment was not appropriate. Specifically, genuine issues of material fact existed as to whether the debtor acted with fraudulent intent in his application to the Oklahoma State Department of Health for a certificate of need to operate the nursing home; whether the debtor obtained money, property, services, or credit by his alleged fraud; and whether the judgment creditor's fraud-based corporate veil-piercing claim arose from actual fraud.

Chapter 7 debtor's discharge denied for having fraudulently transferred property and for failing to keep records from which his business transactions might be ascertained. *In re Devine*, 633 B.R. 626 (Bankr. C.D. Cal. 2021), *aff'd*, No. 8:18-BK-10905-MW, 2022 WL 2444993 (B.A.P. 9th Cir. June 30, 2022)

The United States Trustee ("UST") filed an adversary complaint objecting to the discharge of a chapter 7 debtor who owned a home remodeling business. The debtor's business encountered

[1] Addendum prepared by Erica Garrett and Jacorius Williams, Law Clerks to Judge Cynthia A. Norton, United States Bankruptcy Court for the Western District of Missouri, for the ABI's Litigating Fraud in Consumer Cases Panel, November 2023.

financial difficulty in 2017, which led the debtor to obtain merchant cash advances from several "hard money" lenders who charged interest rates approximating 45 percent per annum. In October 2017, the debtor moved its business to a different location, but did not supervise the move. Subsequently, $50,000 to $60,000 in tools went missing during the relocation. Also, the debtor was hospitalized overnight with high blood pressure, suffered from mental depression, and three separate bouts of pneumonia – causing the business to fail. After defaulting on the loans in November 2017, the lenders obtained confessions of judgment and began levying the debtor's bank accounts – draining moneys needed to keep the business running. The debtor admitted to opening a separate account so that he could continue operating his business without creditor levies, and that he lost track of his expenses on a project-by-project basis. The bankruptcy court held that the debtor would be denied a discharge for having fraudulently transferred property within one year before the petition date and for failing to keep and preserve any books and records from which his financial condition or business transactions might be ascertained.

"Stop and Think": Credit Union charged $450 for filing "dubious" nondischargeability complaint; attorney who filed complaint ordered to run future nondischargeability complaints by the court before filing. *Golden One Credit Union v. Fiedler*, Adv No. 23-2038, 2023 WL 7277985 (Bankr. E.D. Cal. Nov. 2, 2023)

The debtor borrowed $9,000 from Golden One Credit Union in November 2022, and failed to make even the initial payment due the following month. She filed chapter 7 three months later, in March 2023. A week after her § 341 meeting, Golden One filed a "boilerplate" nondischargeability complaint under § 523(a)(2)(A) for fraud, alleging only two operative facts: that the debtor borrowed the money and did not make the first payment. The bankruptcy court said those two facts, without more, were insufficient to prove intentional fraud. Further, the court said, Golden One did not attempt to identify any other facts to support its complaint, did not attend the § 341 meeting of creditors, and ignored the debtor's pro se response explaining why she took out the loan and didn't repay it. One week after the court held a status conference, Golden One requested its complaint be dismissed. The bankruptcy court granted the motion to dismiss, but ordered Golden One to show it had conducted a proper investigation before it filed the complaint. Pointing out that Rule 9011 requires litigants to "stop and think before making legal or factual contentions," the court held that, while early payment defaults can be indicative of fraud, they do not prove fraud. Instead, the court said, such circumstances are a "fraud indicator" which means the debtor has some explaining to do. Section 523(d) exposes creditors to liability for a debtor's attorney fees and costs associated with a successful defense of a § 523(a)(2) complaint which is not substantially justified. Given that "[u]nsupported allegations in a creditor's pleading are not sufficient to carry the creditor's burden under [§] 523(d)," and since there were no special circumstances making an award under § 523(d) unjust, the court awarded the debtor $450 in costs for defending the adversary. In making its award, the court noted six other occasions where Golden One's attorney files

similar boilerplate complaints, ordering the creditor's attorney to submit future complaints for his prefiling review until June 30, 2025.

Faculty

Hon. Cynthia A. Norton is a U.S. Bankruptcy Judge for the Western District of Missouri in Kansas City. Prior to her appointment on Feb. 1, 2013, she was a founding partner of Grimes & Rebein, LC in Lenexa, Kan., where she focused on consumer and business bankruptcy, creditors' rights, commercial workouts and related fields. She also clerked for Hon. John E. Rees of the Kansas Court of Appeals and Hon. James A. Pusateri of the U.S. Bankruptcy Court in Topeka, Kan., and was previously an associate with Stinson, Mag & Fizzell, an associate and then partner with Lewis, Rice & Fingers, and Of Counsel with Levy & Craig, and established her own law firm in 1995. She has published an annual column reviewing Eighth Circuit bankruptcy cases of interest for *Norton's Bankruptcy Law Advisor* and has authored numerous articles, book chapters and seminar papers on bankruptcy-related topics, is a Fellow in the American College of Bankruptcy and a member of various bankruptcy organizations. She also is the recipient of the Michael R. Roser Excellence in Bankruptcy Award and the Robert L. Gernon Award for Outstanding Contribution to CLE, as well as the NCBJ Excellence in Education Award. Judge Norton received her B.A. in French and art history Phi Beta Kappa and *summa cum laude* from Kansas University in 1981, and her J.D. from the Kansas University Law School in 1984, where she was associate editor of its law review.

Summer M. Shaw is the founder of Shaw & Hanover PC, a bankruptcy boutique law firm serving Southern California with its main office located in Palm Desert, Calif. She is a Bankruptcy Specialist certified by the State Bar of California and represents debtors, creditors and trustees in chapter 7, 11, 12 and 13 bankruptcy proceedings and enjoys litigating matters before the U.S. Bankruptcy Courts in the Central District of California. Ms. Shaw is a very active member of the bankruptcy bar and has served as a professor of bankruptcy law at the California Desert Trial Academy (CDTA). She also served as co-chair of ABI's first Consumer Practice Extravaganza in 2021, and she served as an education co-chair for the Consumer Education Programs at the Annual California Bankruptcy Forum Conferences for 2016 and 2019. In addition, she has been invited to speak at various education programs covering secured debt litigation, small business bankruptcies, individual chapter 11s, and bankruptcy law and crossover issues with civil litigation, family law, probate law and criminal law. Ms. Shaw is admitted to practice in all state and federal courts in California as well before the Ninth and Tenth Circuit Court of Appeals, and before the U.S. District Court for the Central District of California. She enjoys volunteering her time as often as possible through her local bar association's "Lawyer in the Library" program, assisting veterans through the Veterans Legal Institute, and volunteering her time to help educate new attorneys in the bankruptcy community whenever possible. Ms. Shaw was a selected as a member of the inaugural class of ABI's "40 Under 40" in 2017, and in 2018, she received the National Association of Consumer Bankruptcy Attorney's National Distinguished Service Award. She has also been named one of *Palm Springs Life Magazine*'s Top Bankruptcy Lawyers and was honored to be a part of the 2015 and 2016 Central District of California Bankruptcy Court's *Pro Bono* Honor Roll. Ms. Shaw received her B.S. in political science with a minor in law and society from the University of California, Riverside and her J.D. from Western State College of Law.

Prof. Michael D. Sousa is an associate professor of bankruptcy and commercial law at the University of Denver's Sturm College of Law in Denver, where he teaches and pursues scholarship in the areas of bankruptcy law, corporate reorganizations, commercial law, secured transactions, debtor/creditor

rights and remedies, sales and business planning. Prior to joining the faculty, he was an associate in the Business Reorganization and Financial Restructuring Practice Group at Duane Morris LLP and served as a judicial law clerk in both state and federal court. Prof. Sousa previously was an adjunct professor of law at Rutgers University School of Law and Seton Hall University School of Law. He served as a law clerk in federal bankruptcy court for Hon. Rosemary Gambardella, Chief Bankruptcy Judge for the U.S. Bankruptcy Court for the District of New Jersey, and for Hon. Donald H. Steckroth, Bankruptcy Judge for the U.S. Bankruptcy Court for the District of New Jersey. He also clerked for Hon. William J. Martini of the U.S. District Court for the District of New Jersey and for Hon. John E. Wallace, Jr. in the Appellate Division of the New Jersey Superior Court. Prof. Sousa is a contributing editor to four national bankruptcy publications, including the *Journal of Bankruptcy Law and Practice*, the *American Bankruptcy Institute Journal*, the *Norton Annual Survey of Bankruptcy Law* and the multi-volume treatise *Norton Bankruptcy Law and Practice 3d*. He also co-authored the *Consumer Bankruptcy Manual*, published by Thomson Reuters, and is a member of the editorial advisory board for the *Journal of Bankruptcy Law and Practice*. Prof. Sousa received his J.D. from Rutgers University School of Law, his LL.M. in bankruptcy from St. John's University School of Law and his M.A. in anthropology from the University of Denver, and he is currently pursuing a Ph.D. in sociology from the University of Colorado – Boulder.

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