

JULY 2024

UT LAW CLE

 **TEXAS Law**
The University of Texas at Austin
School of Law

EXCEPTIONS TO DISCHARGE UNDER 523

Review of hot topics and case update in section 523 litigation

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 **TEXAS Law**

11 U.S.C. § 523 – Exceptions to Discharge

- One of the primary purposes of bankruptcy is to discharge certain debts to give an honest debtor a “fresh start.”
- The right to a discharge is **not absolute**.
- 11 U.S.C. §523 sets forth the statutory exceptions to discharge.
 - Some exceptions are automatic; while others require a creditor to initiate an adversary proceeding to obtain a judicial determination whether the debt to be excepted from discharge is of the type and kind set forth in 11 U.S.C. § 523 (See FED. BANKR. RULE 7001(6)).

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11 U.S.C. § 523 – Exceptions to Discharge

- This presentation is focused on a case update on various §523 related issues and other important considerations that arise largely in connection with the following exceptions to discharge:
 - 11 U.S.C. § 523 (a)(2)(A),(B) – fraud, false pretenses, false representations
 - 11 U.S.C. § 523 (a)(4) – fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny
 - 11 U.S.C. § 523 (a)(6) – willful and malicious injury by the debtor to another entity or its property (See 11 USC §101(15) for definition of entity, which includes people)

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11 U.S.C. § 523 (a)(2)(A),(B) – Fraud, False Pretenses, False representations

- (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;

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11 U.S.C. § 523 (a)(4) – Fraud, False Pretenses, False Representations

- (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;**

Notable Cases:

- *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013) (discussing heightened standard for defalcation while acting in a fiduciary capacity).
- *Chapman v. Forsyth*, 43 U.S. 202, 207 (1840)) and *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934) (a fiduciary relationship under §523(a)(4) is limited to express or technical trusts).
- *Angelle v. Reed (In re Angelle)*, 610 F.2d 1335, 1341 (5th Cir. 1980)(finding “it is entirely fair to charge contractors with intent to create a trust simply because they have entered into a contract governed by a statute”).
- *In re Schwager*, 121 F.3d 177, 186 (5th Cir. 1997) (clarifies that a partner's duties to other partners “fall squarely within” the definition of a fiduciary duty under § 523(a)(4)).
- *LSP Inv. P'ship v. Bennett (In re Bennett)*, 989 F.2d 779, 787 (5th Cir. 1993) (Texas law imposes trust obligations on partners, which meet the requirements under §523(a)(4)).
- *In re Miller*, 156 F.3d 598, 602 (5th Cir. 1998)(embezzlement under §523(a)(4) is the fraudulent appropriation of property by a person to whom such property was entrusted, or in whose hands it has lawfully come).
- *n re Patton*, 129 B.R. 113, 117 (Bankr.W.D.Tex.1991)(explaining that larceny differs from embezzlement with respect to the way the funds or property come into the possession of a party; property unlawfully appropriated at the outset is larceny, whereas embezzlement occurs when property is appropriated after it was entrusted to one's care).

11 U.S.C. § 523 (a)(6) – Willful and Malicious Injury by the Debtor

- (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;**

Notable Cases:

- *Kawaauhau v. Geiger*, 523 U.S. 57, 61 - 62 (1998) (willful and malicious injury means a “deliberate or intentional injury, in which there must be intent to cause the injury, not just the act which leads to the injury).
- *Shcolnik v. Rapid Settlements Ltd. (In re Shcolnik)*, 670 F.3d 624, 629 (5th Cir. 2012) (quoting *Miller v. J.D. Abrams Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 1998))(intent to cause injury exists “where there is either an objective substantial certainty of harm or a subjective motive to cause harm”).
- *LaFavers v. Arguello*, 448 F.Supp.3d 655 (S.D. Tex. 2020), *Chowdary v. Ozcelebi (In re Ozcelebi)*, 640 B.R. 884, 905 (Bankr. S.D. Tex. 2022) (citing *Berry v. Vollbracht (In re Vollbracht)*, 276 Fed. App'x. 360, 361–62 (5th Cir. 2007))(the objective standard requires a court to analyze from a reasonable person's perspective “whether the defendant's actions were substantially certain to cause harm, [and] are such that the court ought to infer that the debtor's subjective intent was to inflict a willful and malicious injury on the plaintiff”).
- *Mahadevan v. Bikkina (In re Mahadevan)*, 617 F. Supp. 3d 654, 660 (S.D. Tex. 2022) (citing *In re D'Amico*, 509 B.R. 550, 561 (S.D. Tex. 2014))(substantial certainty does not mean absolute certainty, but it must be something more than a high probability).

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First appeared as part of the conference materials for the
2024 Consumer Bankruptcy Practice session

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