

JULY 2024

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 **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

ERIN E. JONES
Partner, Jones Murray LLP

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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).

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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
"Exceptions to the 523 Discharge"