

HOW MUCH NOTICE MUST A CREDITOR HAVE OF A DEBTOR'S BANKRUPTCY BEFORE ITS CLAIM IS DISCHARGED?

Only the courts know for sure. In a recent opinion issued by the U.S. Fifth Circuit Court of Appeal, the court gave yet another answer to that vexing question. *Matter of Kendavis Holding Co.*, 2001 WL 409499, --- F.3d ---, (4/23/2001). The answer is that there is no answer: the quality of the notice and knowledge necessary to discharge a claim varies with the circumstances and requires a fact-specific analysis in every case. Simply put, there is no "bright-line" rule. Even a creditor's actual knowledge of a bankruptcy is not always enough to support discharge of a claim.

Generally, confirmation of a Chapter 11 plan discharges all claims that arose before the date of confirmation held by creditors who had "notice or actual knowledge of the case in time for . . . timely filing . . ." of a proof of claim regardless of whether a claim was actually filed or scheduled. 11 U.S.C. § 523(a)(3)(A); *see also* 11 U.S.C. § 1141(d)(1)(A). But in *Kendavis*, the court ruled that a creditor's actual knowledge of the pending bankruptcy does not satisfy the requirements of constitutional due process in every circumstance. Thus, the U.S. Constitution may require something more than that required under 11 U.S.C. § 523(a)(3)(A).

The creditor in *Kendavis* was a retired employee who filed suit because he claimed he received less than his full pension benefits due him under the company plan. In response, the debtor-company moved to reopen its bankruptcy case, alleging that the confirmation order entered ten years earlier had discharged the employee's claim. The employee admitted that he had actual knowledge of the bankruptcy through newspaper accounts at the time, but he had also received the company's letter during the bankruptcy telling him his pension benefits would not be affected. Not only did the bankruptcy court rule his claim was discharged, but it sanctioned the employee \$40,000 for violating the discharge injunction. The district court reversed the bankruptcy court, and the Fifth Circuit affirmed the district court's decision.

The Fifth Circuit reviewed both its earlier precedent and that of the U.S. Supreme Court to determine what notice the Constitution requires in each circumstance. The court reviewed the U.S. Supreme Court's 1950 decision in *Mullane v. Central Hanover Bank & Trust Co.* and concluded that it must review the facts of each case to "determine whether the method used to notify an individual was reasonably certain to inform the individual of a proceeding that

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could affect his rights.”

Before *Kendavis*, the Fifth Circuit in *In re Sam* had stated that the notice must tell the creditor about pending actions affecting its rights and that the notice must allow sufficient time for the creditor to present its claim or objections. *In re Sam*, 894 F.2d 778, 782 (5th Cir. 1990). Later, in *In re Sequa Corp.*, 28 F.3d 512 (5th Cir. 1994), the Fifth Circuit concluded that actual knowledge satisfied constitutional due process for the post-petition creditors and that formal notice of the case and deadlines was not required. But the court was careful to limit that holding to the precise factual situation before it and therefore stated in *Kendavis* that *In Re Sequa* “does not espouse a rule that would preclude further consideration of the context in which a creditor learns of a bankruptcy.”

Thus, in *Kendavis*, the court ruled **actual knowledge** was **not** sufficient to have discharged the employee’s claim, although it was enough in the facts presented by *In re Sequa*. The apparent distinguishing factors were that the employee had received an affirmative assurance that his rights would not be affected and that the employee was not represented by counsel. Accordingly, the Fifth Circuit reasoned that “[d]ue process requires, at the very least, a debtor to refrain from assuring potential creditors that their rights will not be adversely affected” So how much notice is required before a claim is discharged in bankruptcy? It depends: “adequate notice” must be “reasonably calculated” under the “factual circumstances” to inform a creditor that a proceeding may affect its rights.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

R. Patrick Vance
Jones Walker
201 St. Charles Ave., 49th Fl.
New Orleans, LA 70170-5100
ph. 504.582.8194
fax 504.589.8194
email pvance@joneswalker.com