IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

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IN RE
WILLIAM HENRY GRAY,

Debtor.

OPINION AND
ORDER

99-C-0800-C
00-C-0042-C

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WILLIAM HENRY GRAY,

Debtor-appellant,

v.

DELBERT BERRY, JOHN W. BOCQUET,
MYRTLE BOCQUET, MICHAEL E. DAMAL,
CHRIS ENGEN, BRAD HAGEN, DAN HARPER,
CHRIS HUGGINS, MARK P. JACKSON,
SCOTT McKAY III, TAMARA RANK,
DALE ROTHLISBERGER, DAVID TODD,
MICHAEL TODD, THOMAS T. TREYBIG,
CLAXTON SEELY, SUE ELLEN SEELY,
JEFFREY RAGAN SEELY, DUANE HOWARD,
PETER D. LENNON, SUSAN Y. DESJARDINS,
WOODSON HUGGINS, ANNETTE HUGGINS,
TOMMIE STONE, WADE PETERSON,
DEBRA PETERSON, BJORN DYBDAHL,
J.R. DICK SCOTT, TODD SULLIVAN,
PAUL GRIFFIN AND KIMBERLY GRIFFIN,

Creditors-appellees.

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This case is a consolidated appeal brought pursuant to 28 U.S.C. § 158(a). Debtor-appellant William Henry Gray contends that the United States Bankruptcy Court for the Western District of Wisconsin issued two erroneous orders on October 27, 1999. In the first order, the bankruptcy court dismissed the joint complaint of thirty-one creditors-appellees objecting to the dischargeability of their claims against debtor, with leave to refile separate adversary proceedings before February 15, 2001. Debtor contends that the bankruptcy judge violated Rule 4007(c) of the Federal Rules of Bankruptcy Procedure by sua sponte extending the filing deadline for contesting dischargeability under 11 U.S.C. § 523. In the second order, the bankruptcy court granted creditors-appellees relief from the automatic stay imposed by 11 U.S.C. § 362 to allow them to proceed in a pending lawsuit in Texas state court. Debtor contends that by allowing creditors-appellees to proceed in state court, the bankruptcy judge acted in violation of the injunction under 11 U.S.C. § 542 that resulted from the discharge order. I conclude that the orders of the bankruptcy court will be affirmed. The bankruptcy judge did not abuse his discretion either in dismissing creditors-appellees' joint complaint and giving them permission to refile individual complaints before February 15, 2001 because creditors-appellees had filed a timely complaint contesting dischargeability under § 523(c), or in granting creditors-appellees relief from the stay to pursue their claims in state court because

the discharge order did not discharge the debts contested in their dischargeability complaint.

From the briefs submitted by the parties and the record on appeal, I find the following facts solely for purposes of ruling on debtor's consolidated appeal.

FACTS

On October 28, 1998, creditors-appellees filed a lawsuit in Texas against debtor and two other defendants for fraud, statutory fraud, fraudulent inducement, civil conspiracy and unjust enrichment. On February 16, 1999, debtor filed a voluntary Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Wisconsin, triggering the automatic stay provision of 11 U.S.C. § 362(a). On March 29, 1999, the bankruptcy court held the first meeting of the creditors and gave notice that May 28, 1999 was the deadline for filing a complaint to determine the dischargeability of a debt owed by debtor.

On May 28, 1999, thirty-one creditors filed a single complaint in the bankruptcy court, objecting to the dischargeability of their claims against debtor under 11 U.S.C. §§ 523(a)(2), (a)(4) and (a)(6). Specifically, creditors-appellees alleged that debtor had committed fraud and misrepresentation by inducing them to invest over $1,000,000 in a company of which debtor was the president, CEO and a director.

On June 1, 1999, the bankruptcy court issued a discharge order, granting debtor a

discharge pursuant to 11 U.S.C. § 727. The discharge order specified that "This order does not affect any pending adversary proceedings to determine dischargeability." On June 10, 1999, debtor moved to dismiss creditors-appellees' complaint or in the alternative, to sever their individual claims. In July 1999, creditors-appellees moved for relief from the automatic stay in order to pursue their lawsuit in state court, arguing that Texas was the appropriate forum because all of the parties except debtor were located in Texas and the events relevant to both creditors-appellees' suit in state court as well as their nondischargeability complaint in bankruptcy court occurred in Texas.

In August 1999, creditors-appellees filed a first amended complaint in which they made specific allegations with respect to individual creditors. In September 1999, debtor filed five motions to dismiss creditors-appellees' amended complaint. On October 18, 1999, the bankruptcy court held a hearing regarding debtor's motion to dismiss creditors-appellees' nondischargeability complaint and creditors-appellees' motion for relief from the automatic stay. At the conclusion of the hearing, the court orally dismissed creditors-appellees' nondischargeability complaint, holding that creditors-appellees could replead their individual claims in bankruptcy court before February 15, 2001, and granted relief from the automatic stay to allow creditors-appellees to proceed in the Texas lawsuit, stating that final judgment would not be entered against debtor pending further order of the bankruptcy court. On

October 27, 1999, the bankruptcy court entered two written orders reflecting the decisions announced at the October 18 hearing:

> 1) IT IS ORDERED that the captioned adversary proceeding be, and it hereby is, dismissed.
>
> IT IS FURTHER ORDERED that the captioned plaintiffs may, on or before February 15, 2001, file separate adversary proceedings objecting to the dischargeability of debt in the captioned bankruptcy case.
>
> 2) IT IS ORDERED that the motion for relief from stay is granted, and the moving creditors may proceed in state court. Final judgment shall not be entered against the debtor pending further order of this Court.

OPINION

A. Standard of Review

Rule 8013 of the Federal Rules of Bankruptcy Procedure states: "On an appeal, the district court . . . may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." A bankruptcy court's factual findings are reviewed for clear error; its conclusions of law are reviewed de novo. See In re Thirtyacre, 36 F.3d 697, 700 (7th Cir. 1994). Review of a bankruptcy court's decision to grant relief from an automatic stay is limited to whether the court abused its discretion. See In re C & S Grain Co., 47 F.3d 233, 237-38 (7th Cir. 1995).

B. Order Allowing Creditors-Appellees to Refile Dischargeability Complaints

"Although Chapter 7 affords a fresh start to individual debtors after bankruptcy, some debts can survive whole despite a general discharge." In re Meyer, 120 F.3d 66, 68 (7th Cir. 1997). Section 523(a) of Chapter 11 specifies certain kinds of debts that are exceptions to a general discharge for an individual debtor. "Among them are those that a debtor incurred with the aid of fraud and deceit." Meyer, 120 F.3d at 68; see 11 U.S.C. §§ 523(a)(2)(A)-(B), (a)(4) and (a)(6). However, even these debts are discharged "unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge." 11 U.S.C. § 523(c)(1).

Bankruptcy Rule 4007(c) requires that creditors file a complaint to determine the dischargeability of any debt pursuant to § 523(a) within 60 days of the first meeting of creditors. According to the Court of Appeals for the Seventh Circuit, the purpose of Rule 4007(c) is to "encourage[] creditors to file their complaints speedily or yield them forever," and

> define[] a time certain when creditors may no longer come claiming that the debtor defrauded them and that certain debts should be non-dischargeable. After the 60 days are over, all the demands for non-discharge that can be made, have been made. The debtor can relax.

Meyer, 120 F.3d at 68-69. However, the focus of the limitation under Rule 4007(c) is on the debt, not the parties. "The force of Rule 4007(c) therefore should fall first and foremost on whether a complaint was filed against a specific debt . . . ." Id. (rejecting debtor's attempt to characterize creditor's nondischargeability claim as tardy because debtor was given timely

notice even though creditor that filed within 60-day time frame was technically the wrong party, stating that "Rule 4007(c) turns on the identification of a contested debt").

The court may extend the 60-day deadline for filing a nondischargeability complaint "[o]n motion of any party in interest, after hearing on notice" if the motion is "made before time has expired." Bankruptcy Rule 4007(c); see Bankruptcy Rule 9006(b)(3) (permitting an enlargement of the time set under Rule 4007(c) "to the extent and under the conditions stated in those rules"). In arguing that the bankruptcy court violated Bankruptcy Rule 4007(c) by allowing creditors-appellees to file individual dischargeability complaints after the expiration of the 60-day time frame and in the absence of a proper motion for an extension, debtor misunderstands the nature of the bankruptcy judge's order. An extension is required only when creditors have not filed a timely complaint. Because creditors-appellees filed a timely complaint on May 28, 1999, within 60 days of the first meeting of the creditors, there was no need for an extension of the deadline imposed by Rule 4007(c).

The bankruptcy judge did not abuse his discretion in dismissing creditors-appellees' joint complaint and giving them permission to refile individual complaints before February 15, 2001. Although creditors-appellees had filed a timely complaint, interests of judicial efficiency made it appropriate for the Texas state court to resolve the fraud allegations against debtor because of the similarity and significant overlap between creditors-appellees' state law claims and

nondischargeability claims and because most of the parties were located in Texas and the events relevant to the suit had occurred in Texas. The procedural course the bankruptcy judge chose is not unique. Other courts have approved a similar route. See Allred v. Kennerley (In re Kennerley), 995 F.2d 145, 148 (9th Cir. 1993) ("Had [creditor] filed a timely complaint to determine dischargeability, he could have returned [to bankruptcy court] after the state court action" and had "the dischargeability of the debt determined."); In re Saunders, 103 B.R. 298, 299 (Bankr. N.D. Fla. 1989) ("it is within the discretion of the Bankruptcy Court to permit a closely related claim to be reduced to judgment in a state or other court of competent jurisdiction. . . . Judicial economy may dictate the Court's exercise of discretion, especially in a case such as this, where the issues appear inextricably intertwined with pending state court litigation."); Kowalewycz v. Sears (In re Sears), 68 B.R. 34, 35 (Bankr. W.D. Mo. 1986) ("If and when a state court judgment is obtained by the plaintiff, the bankruptcy court may then make the determination of its dischargeability vel non on the basis of the state court record plus any relevant supplemental evidence which the parties may desire to adduce.").

Rather than staying proceedings relating to creditors-appellees' nondischargeability complaint pending resolution of the case in state court, the bankruptcy judge dismissed the complaint, requiring creditors-appellees to refile individual complaints upon their return to bankruptcy court because of the differing factual circumstances in which each creditor's claim

arose. Although technically the bankruptcy judge would be allowing creditors-appellees to file a new complaint after expiration of the 60-day time frame set forth in Rule 4007(c), creditors-appellees satisfied Rule 4007(c)'s goal of giving the debtor timely notice of their specific allegations of nondischargeability in their complaint. Meyer, 120 F.3d at 68-69. The Seventh Circuit has held that a bankruptcy court may "act to assure that 'fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." In re Stavriotis, 977 F.2d 1202 (7th Cir. 1992) (quoting In re International Horizons, Inc., 751 F.2d 1213, 1216 (11th Cir. 1985)). Because creditors-appellees gave debtor fair warning of their claims by filing a timely complaint contesting dischargeability under § 523(c), the bankruptcy judge acted within his discretion in dismissing their complaint without prejudice to their refiling individual complaints following an adjudication in state court on their fraud claims.

C. Order Granting Relief From Stay

Three days after creditors-appellees filed their nondischargeability complaint, the bankruptcy judge entered an order granting debtor a discharge under 11 U.S.C. § 727. The bankruptcy judge specified that the discharge order did "not affect any pending adversary proceeding to determine dischargeability." In other words, he excluded from discharge the

debts that were the subject of creditors-appellees' nondischargeability complaint. As to any debts discharged by the order, the discharge "operate[d] 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." 11 U.S.C. § 524(a)(2). As to any debts not subject to the discharge order, the automatic stay pursuant to 11 U.S.C. § 362(a) remained in effect until the bankruptcy judge lifted it to allow creditors-appellees to pursue their claims in Texas.

The discharge order excluded the debts that were the subject of "any pending adversary proceeding" as of June 1, 1999, the date the order was entered. Debtor argues that when the bankruptcy judge dismissed creditors-appellees' complaint in October 1999, the previously excluded debts were discharged because there was no longer any "*pending* adversary proceeding to determine dischargeability" and, as a result, the discharge order operated as an injunction barring creditors-appellees' lawsuit in Texas. See § 524(a)(2). Debtor cannot rewrite the discharge order to include debts that were specifically excluded when the judge decided to dismiss creditors-appellees' complaint of nondischargeability under § 523(a)(2), (4) and (6) without prejudice to creditors-appellees' refiling individual complaints following resolution of similar claims in the Texas lawsuit. That the dismissal did not resolve creditors-appellees' nondischargeability complaint in bankruptcy court is supported by the specification in the

order that final judgment could not be entered without further order of the court. See In re Lambert, 76 B.R. 131, 131 (E.D. Wis. 1985) (affirming decision of bankruptcy judge that if creditor prevailed in state court, hearing on dischargeability would be required prior to enforcement of state court judgement, stating "The judge's order is consistent with the principles behind the bankruptcy law, which preclude a debtor from escaping liability for fraudulent actions.")

The discharge order did not discharge the debts that creditors-appellees contested in their dischargeability complaint. See Union National Bank of Marseilles v. Leigh (In re Leigh), 165 B.R. 203 (Bankr. N.D. Ill. 1994) ("The discharge order specifically contemplates the possibility of a determination by the [bankruptcy court], after the date of discharge, that certain debts may be non-dischargeable under § 523(a)(2), 523(a)(4), or 523(a)(6).") Because the automatic stay of creditors-appellees' state court suit was not converted into an injunction, the bankruptcy judge did not violate the § 524(a) statutory injunction by granting creditors-appellees relief from the stay to pursue their claims.

ORDER

IT IS ORDERED that the decisions of the United States Bankruptcy Court for the Western District of Wisconsin dismissing the complaint of creditors-appellees and allowing

them to refile before February 15, 2001, and granting creditors-appellees relief from the automatic stay are AFFIRMED.

Entered this _____ day of April, 2000.

BY THE COURT:

_____
BARBARA B. CRABB
District Judge