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Introduction

Under title 11 of the United States Code (the "Bankruptcy Code"), a discharge of a debt "operates as an injunction against the commencement or continuation of an action . . . to collect, recover, or offset any debt as a personal liability of the debtor."[1] This discharge is the "principle advantage bankruptcy offers an individual" because it provides the debtor with a "fresh start" by freeing him from the chains of previous debts. [2]

Even so, a "discharge in bankruptcy does not extinguish the debt itself, but merely releases the debtor from personal liability for the debt."[3] Therefore, as provided by section 524(e) of the Bankruptcy Code, "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."[4] Consequently, courts

[1] 11 U.S.C. § 524(a)(2). Section 524(a)(3) has the same effect as section 524(a)(2), but concerns the interests of the debtor and debtor's spouse in community property as of the commencement of a bankruptcy case and is not addressed here.
[2] Thomas H. Jackson, *The Fresh-Start Policy In Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393 (1985). Some debts are nondischargeable. *See* 11 U.S.C. §§ 523(a)(1)–(17) (specifying nondischargeable debts include domestic support obligations, unpaid taxes, and property or credit obtained through fraud).
[3] *In re* Edgeworth, 933 F.2d 51, 53 (5th Cir. 1993).
[4] 11 U.S.C. § 524(e).

hold insurers liable for the debtor's insured debt and creditors can "establish[] their liability by proceeding against a discharged debtor."[5]

This memorandum will explore whether a discharge under section 524 precludes a suit to recover from a discharged debtor's insurer. Part I analyzes the impact of the "fresh start" policy in bankruptcy law. Part II examines the scope of a section 524 discharge and its application to a discharged debtor's insurer. Part III concludes by analyzing the convergence of these two concepts as preventing creditors from bringing a suit to recover from a discharged debtor's insurer when the action would impair the debtor's fresh start.

Discussion

I. A Discharge is Designed to Give a Debtor a Financial Fresh Start.

Courts consistently hold that a discharge injunction in bankruptcy law "furthers one of the primary purposes of the Bankruptcy Code—that the debtor have the opportunity to make a financial fresh start."[6] A discharge under section 524 is a fresh start because it "frees the debtor of his personal obligations" and also protects the debtor from adverse consequences that may result from his release.[7] Furthermore, the legislative history of section 524 evidences that the section is designed to give a discharged debtor a fresh start. For example, the Senate Report explains that section 524 is designed "to ensure that once a debt is discharged, the debtor will not be pressured in any way to repay it."[8]

It is well established that section 524 of the Bankruptcy Code protects a discharged debtor from exposure to personal liability by acting as a permanent injunction to all actions to

[5] *In re* Edgeworth, 933 F.2d at 54.
[6] Green v. Welsh, 956 F.2d 30, 36 (2d Cir. 1992); *see also In re* CJ Holding Co., No. 16-33590, 2018 WL 3965225, at *2–3 (Bankr. S.D. Tex. Aug. 15, 2018).
[7] *Green*, 956 F.2d at 33.
[8] S. REP. NO. 95-989, at 80–81 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5866.

collect discharged debts.[9] In *In re Covelli*, the United States Bankruptcy Court for the Southern District of New York refused to lift an automatic stay to allow a creditor to pursue a discharged debt against the debtor in state court.[10] There, the creditor sought to hold the debtor personally liable for discharged mortgage debt and the court held the creditor's actions were "precisely what is enjoined by the discharge injunction, **as this Court has repeatedly made clear**."[11] The court recognized that the "discharge injunction furthers one of the basic principles of bankruptcy–to provide the debtor with a fresh start."[12]

II. Discharge Under Section 524 Does Not Preclude a Suit to Recover From an Insurer.

Courts are nearly unanimous in holding "the scope of a section 524(a) injunction does not affect the liability of liability insurers and does not prevent establishing their liability by proceeding against a discharged debtor."[13] Judge Richard Allen Posner of the United States Court of Appeals for the Seventh Circuit explained that "a suit to collect merely the insurance proceeds . . . would not create 'a personal liability of the debtor,' because only the insurance company would be asked to pay anything, and hence such a suit would not infringe the discharge."[14]

Indeed, "the foundation of this reading of § 524(a)(2) is that it makes no sense to allow an insurer to escape coverage for injuries caused by its insured merely because the insured receives

[9] *See In re* Edgeworth, 933 F.2d at 53 ("In general, section 524 protects a debtor from any subsequent action by a creditor whose claim has been discharged in a bankruptcy case."); *see also* In re Covelli, 550 B.R. 256, 266 (Bankr. S.D.N.Y. 2016) (protecting a debtor from personal liability for discharged mortgage debt).
[10] *Id.* at 270
[11] *Id.* at 268 (emphasis in original).
[12] *Id.* at 266.
[13] *See, e.g.*, *In re* Edgeworth, 933 F.2d at 54 ("Section 524(e) specifies that the debt still exists and can be collected from any other entity that might be liable."). The Sixth Circuit stands alone and declines to follow this interpretation of section 524. *See In re* White Motor Credit, 761 F.2d 270 (6th Cir. 1985). Section II of this memorandum discusses the Sixth Circuit interpretation of section 524.
[14] *In re* Hendrix, 986 F.2d 195, 197 (7th Cir. 1993) (citing 11 U.S.C. § 524(a)(2)).

a bankruptcy discharge."[15] In *In re Edgeworth*, the Fifth Circuit allowed a creditor to initiate a medical malpractice suit to pursue the debtor's medical malpractice liability policy after the debtor's chapter 7 discharge.[16] In its reasoning the court stated, "[t]he 'fresh-start' policy is not intended to provide a method by which an insurer can escape its obligations based simply on the financial misfortunes of the insured."[17]

Likewise, in *Green v. Welsh*, the United States Court of Appeals for the Second Circuit held that "§ 524 permits a plaintiff to proceed against a discharged debtor solely to recover from the debtor's insurer."[18] There, the Second Circuit permitted a creditor to bring a post-discharge suit, but only to establish a landlord's negligence for a fire "as a precondition to recovery from the [debtor's] liability insurer."[19] In reaching its holding, "the court emphasized that neither the fresh-start policy nor § 524 was designed to immunize third parties such as insurers who may be liable on behalf of the debtor."[20] Further, the court stated that "the insurer should not gain a benefit that had not figured in the calculation of the premium for the policy."[21]

The Sixth Circuit is the only circuit that holds a discharge under section 524 precludes a suit to recover an insured claim from an insurer.[22] The Sixth Circuit in *In re White Motor Credit* barred the continuation of personal injury claims that would have been paid by the debtor's insurers.[23] However, the Sixth Circuit's approach has been repeatedly criticized and was explicitly rejected by the Eleventh Circuit[24] and by the Second Circuit.[25]

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[15] *In re* Edgeworth, 933 F.2d at 54.
[16] *Id.* at 56.
[17] *Id.* at 54 (citing *In re* Jet Florida, 883 F.2d 970, 975 (11th Cir.1989) (per curiam) (adopting the district court opinion).
[18] Green v. Welsh, 956 F.2d 30, 35 (2d Cir. 1992).
[19] *Id.*
[20] *Id.* at 34.
[21] *Id.*
[22] *See In re* White Motor Credit, 761 F.2d 270 (6th Cir. 1985).
[23] *See id.* at 275.

III. Courts Have Refused to Allow a Suit to Recover From a Discharged Debtor Where the Debtor Would Incur Substantial Costs.

The "insurance exception is not absolute."[26] Indeed, courts have refused to lift an injunction to allow a creditor to pursue recovery against the debtor's liability insurer "if the debtor is required to incur substantial costs in the litigation" that would "frustrate" the debtor's discharge and the "fresh start policy engrafted into the Bankruptcy Code."[27] As a result, the court must consider the post-discharge suit's impact on the fresh start of the debtor when answering whether a discharge under section 524 precludes a suit to recover from a discharged debtor's insurer.

Courts have determined costs are "substantial" when they would "frustrate" the debtor's discharge and the "fresh start policy engrafted into the Bankruptcy Code."[28] The *Jones v. Pilgrim's Pride, Inc.* court is instructive on this issue.[29] In *Jones*, the court denied a creditor's request to pursue litigation claims solely for the purpose of collecting insurance proceeds where the debtor had "no primary insurance applicable to [the] claim" because the debtor was largely self-insured and "responsible for all fees and costs up to one million dollars."[30] The court reasoned that "requiring [the discharged debtor] to proceed with litigating . . . would impermissibly infringe upon its right to a financial fresh start."[31]

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[24] *See In re* Jet Florida, 883 F.2d 970, 973–74 (criticizing the *In re White Motor Credit* decision as a "naked conclusion" which had "stemmed from confusion over the district court's order").
[25] *See Green*, 956 F.2d at 34 (stating the *In re White Motor Credit* decision is "supported by neither the text nor the intent of § 524").
[26] Susan N.K. Gummow and John M. Wunderlich, *Suing the Debtor: Examining Post-Discharge Suits Against the Debtor*, 83 AM. BANKR. L. J. 495, 500 (2009).
[27] *In re* CJ Holding Co., 2018 WL 3965225, at *2–3 (denying creditor's motion for relief from the statutory discharge injunction where debtor would be required to pay a one million dollar deductible and a five million dollar self-insured retention policy).
[28] *Id.*
[29] *See* Jones v. Pilgrim's Pride, Inc., 741 F. Supp. 2d. 1272, 1277–78 (N.D. Ala. 2010).
[30] *Id.*
[31] *Id.* at 1279.

Similarly, In *DePippo v. Kmart Corp.*, a bankruptcy court in New York dismissed a creditor's claims when the only applicable insurance coverage was a self-insured retention policy of two million dollars.[32] In dismissing the creditor's claims, the court in *DePippo* reasoned that "[a]llowing the claim would require dipping into bankruptcy assets in order to pay the costs of defending the lawsuit which would be contrary to the Bankruptcy Code's fresh start policy."[33]

On the other hand, courts have held that the burden of attending depositions and trial are not substantial costs that would preclude a suit against a discharged debtor to recover insurance proceeds.[34] Furthermore, even if the insurance company denies coverage, the debtor will not be impermissibly burdened.[35] In *In re Jet Florida Systems, Inc.*, the court stated that if the insurance company is not willing to defend the insured, "the debtor would be free to default because the Plaintiff cannot recover directly from the bankrupt estate."[36]

Conclusion

Section 524 of the Bankruptcy Code does not preclude a creditor from bringing a suit to recover from a discharged debtor's insurer. The purpose of section 524 is to further one of the essential advantages of bankruptcy—to provide the debtor with a financial fresh start. However, the fresh start policy engrained into section 524 shields only the individual debtor from personal liability. Creditors may, however, pursue liability insurers to collect on the debt that is insured. Still, courts must engage in a balancing of the fresh start policy with the ability of a creditor to bring a post-discharge action. In doing so, a court may refuse to allow a creditor to bring a suit to

[32] *See* DePippo v. Kmart Corp., 335 B.R. 290, 298 (Bankr. S.D.N.Y. 2005).
[33] *Id.*
[34] *See In re* Edgeworth, 933 F.2d at 54. ("Thus, as long as the costs of defense are borne by the insurer and there is no execution on judgment against the debtor personally, section 524(a) will not bar a suit against the discharged debtor as the nominal defendant.").
[35] *See In re* Jet Florida Systems, Inc., 883 F.2d at 976.
[36] *Id.* (finding "the possibility that the debtor will be responsible to pay any amount associated with defending this action is so remote that the fresh-start policy is simply not defeated").

recover from an insurer when the debtor would incur substantial costs, such as paying a self-insured retention policy, or paying fees and costs of litigation by dipping into bankruptcy assets.