UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

In re:

CASE NO. 898-80437-478

ALISON SCHWARTZ,

Debtor. **DECISION & ORDER**

GLENN SCHWARTZ,

Plaintiff,

V. **AP NO. 800-8054-478**

ALISON SCHWARTZ,

Defendant.

BACKGROUND

On January 15, 1998, Alison Schwartz (the "Debtor") filed a petition initiating a Chapter 7 Case. On April 23, 1998, an Order was entered granting the Debtor a discharge in her no asset Chapter 7 case. On January 25, 2000, an Order (the "Reopening Order") was entered in response to a motion by the Debtor which: (1) reopened her Chapter 7 case; (2) added as a creditor Glenn Schwartz, her former husband; (3) added as a creditor Dyck-O'Neal, Inc., the then-holder of a Note and Mortgage (the "Chase Mortgage"), originally executed by the Debtor and Glenn Schwartz in favor of Chase Mortgage Corporation ("Chase"), covering the former residence occupied by the Debtor

and Glenn Schwartz, a cooperative apartment located at 334-A Peninsula Boulevard, Cedarhurst, New York (the "Apartment"); and (4) gave Glenn Schwartz and Dyck-O'Neal, Inc. thirty (30) days within which to file a Complaint to determine the dischargeability of any debt that either alleged was due them from the Debtor.

On February 14, 2000, Glenn Schwartz filed an Adversary Proceeding against the Debtor which requested that the Court determine to be nondischargeable a debt due from Glenn Schwartz and the Debtor to Dyck-O'Neal, Inc. in the amount of $36,408.63. This debt (the "Deficiency Debt") was the deficiency due on the Chase Mortgage after the Apartment was sold at foreclosure in May 1997.

The Complaint in the Adversary Proceeding alleged that: (1) on May 1, 1997, the Debtor and Glenn Schwartz were parties to an action for divorce pending in the Supreme Court, Nassau County (the "Divorce Action"); (2) prior to May 1, 1997, the Chase Mortgage had gone into default, a mortgage foreclosure proceeding had been commenced and the Debtor and Glenn Schwartz knew that an auction sale was scheduled to take place in May; (3) by letter dated May 1, 1997, the Debtor's matrimonial counsel recommended to the Hon. George A. Murphy ("Judge

Murphy"), the presiding Supreme Court Justice in the Divorce Action, that he enter an order directing the Debtor and Glenn Schwartz to liquidate their IRA accounts and use the proceeds to bring the Chase Mortgage current; (4) on May 9, 1997, Judge Murphy entered an Order in the Divorce Action (the "IRA Order") which provided in part that: "the Court directs the parties to liquidate forthwith the individual retirement accounts and immediately pay the monies owed (approximately $16,000.00) to Chase Manhattan Mortgage Corporation in order to reinstate the loan"; (5) the Debtor wilfully failed to obey the IRA Order by failing to cash in her IRAs and use the proceeds to reinstate the Chase Mortgage; (6) on or about May 21, 1997, the Apartment was sold at a foreclosure auction for less than the full amount due on the Chase Mortgage, which resulted in the Deficiency Debt; (7) on or about July 8, 1997, the Debtor and Glenn Schwartz executed a stipulation of settlement in the Divorce Action (the "Settlement Agreement"), which contained a provision whereby the Debtor agreed to hold Glenn Schwartz harmless with respect to the Apartment (the "Hold Harmless Provision"); (8) the provisions of the Settlement Agreement were incorporated in the party's December 8, 1997 Divorce Decree; (9) when the Debtor filed her petition, she failed to schedule the Deficiency Debt

or Glenn Schwartz or Dyck-O'Neal, Inc. as creditors; (10) the Debtor was liable to Glenn Schwartz for the full amount of the Deficiency Debt because of her fraudulent conduct and wilful disobedience of the IRA Order; and (11) the debt due from the Debtor to Glenn Schwartz should be determined to be nondischargeable pursuant to Section 523(a)(4), because of the Debtor's fraud, Section 523(a)(6), because of the malicious injury to Glenn Schwartz caused by the Debtor's failure to obey the IRA Order, and Section 523(a)(11).[1]

The Debtor interposed an Answer to the Complaint in the Adversary Proceeding which alleged that: (1) she did not have sufficient knowledge to form a belief as to whether the proceeds from the IRA accounts maintained by her and Glenn Schwartz would

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[1] Section 523(a)(11) provides that:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -
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> > (11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union[.]

11 U.S.C. § 523(a)(11) (2000).

have been sufficient to stop the foreclosure sale of the Apartment; (2) her actions were not wilful, fraudulent or purposeful; (3) the Hold Harmless Provision was only for any expenses or liability which might occur between the foreclosure sale and when she moved out of the Apartment on August 1, 1997; (4) her failure to initially schedule Glenn Schwartz as a creditor in her bankruptcy case was not fraudulent or wilful, but was simply because her attorney failed to advise her to include him as a contingent creditor; and (5) the Chase Mortgage went into default because Glenn Schwartz failed to perform his obligations under a March 7, 1996 Order in the Divorce Action which required him to continue to pay the Mortgage and the carrying charges on the Apartment.

As required by the Bankruptcy Court, the Plaintiff filed a September 15, 2000 pretrial statement (the "Pretrial Statement") which asserted that: (1) the Plaintiff was now proceeding in his request for a determination of nondischargeability under Sections 523(a)(2)(A) and 523(a)(3)(B);[2] and (2) the issues for

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[2] Sections 523(a)(2)(A) and 523(a)(3)(B) provide that:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -
>
> (2) for money, property, services, or an extension, renewal,

the Court to decide were: (a) whether the Debtor was liable to Glenn Schwartz for the full amount of the Deficiency Debt by reason of the Hold Harmless Provision;[3] and (b) did the actions of the Debtor in not complying with IRA Order constitute fraud within the meaning and intent of Section 523(a)(2)(A).

This matter was scheduled for trial on November 30, 2000, before the Hon. John C. Ninfo, II, Chief Judge of the United

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> 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;
> >
> > (3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit -
> >
> > > (B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request[.]

11 U.S.C. §§ 523(a)(2)(A) and (a)(3)(B) (2000).

[3] The Hold Harmless Provision reads as follows:

> The parties acknowledged that the marital residence located at 334A Penninsula Boulevard, Cedarhurst, New York was sold at auction and the cooperative shares purchased by the mortgagee. That the Wife continues to reside at said residence and shall be solely responsible for any and all costs to remain and any and all costs associated therewith and shall hold the Husband harmless and indemnified as to same.

States Bankruptcy Court for the Western District of New York, sitting by the authority of the United States Court of Appeals for the Second Circuit as a Visiting Judge in the Bankruptcy Court for the Eastern District of New York. On the trial date, the parties elected to submit the matter on the pleadings previously filed with the Court, together with post-trial submissions due by December 14, 2000.

DISCUSSION

I. Section 523(a)(3)(B) Cause of Action

Any cause of action Glenn Schwartz may have had under Section 523(a)(3)(B) was rendered moot by the entry of the Reopening Order, signed by United States Bankruptcy Judge Dorothy Eisenberg, which afforded Glenn Schwartz the opportunity, which he took advantage of, to commence an Adversary Proceeding to have the Court determine whether any debt he alleged was due him from the Debtor was nondischargeable.

II. The Hold Harmless Provision

It is clear from the unambiguous language of the Hold Harmless Provision, as well as the facts and circumstances surrounding the execution of the Settlement Agreement, that the

Debtor's agreement to hold Glenn Schwartz harmless with respect to the Apartment was limited to any costs, liabilities or indebtedness which might result from the Debtor's holdover possession of the Apartment from the time of the foreclosure auction sale to the termination of her possession on or about August 1, 1997. The clear language of the Hold Harmless Provision only permits that interpretation.

Furthermore, given that the foreclosure sale had already taken place at the time the Settlement Agreement was entered into, so that the parties knew that a substantial deficiency on the Chase Mortgage had resulted, it would not be reasonable to conclude that the Debtor would have agreed by the Hold Harmless Provision to be solely liable for the Deficiency Debt. If that had been the intention of the parties, the Hold Harmless Provision would have been more detailed and specific on that point. This is especially true given what appears to be an otherwise extensive and detailed Settlement Agreement, ending, what appears to have been, a contentious divorce action.

III. Section 523(a)(2)(A) Cause of Action

In order to prevail on a §523(a)(2)(A) cause of action based upon fraud, a plaintiff must establish, by a preponderance of the evidence, the following five elements: (1) a representation;

(2) falsity; (3) scienter; (4) justifiable reliance; and (5) damage. *In re Mitchell,* 227 B.R. 45 (Bankr. S.D.N.Y. 1998).

After reviewing the pleadings filed by Glenn Schwartz in the Adversary Proceeding, a summary of his argument on actual fraud is as follows: (1) the Debtor made a false representation to Glenn Schwartz, which was that she would liquidate her IRA accounts and pay the proceeds of the accounts to Chase so that the Chase Mortgage would be reinstated and the foreclosure sale scheduled for the Apartment discontinued, provided Glenn Schwartz also liquidated his IRA accounts and paid the proceeds to Chase; (2) although this false representation was not directly made by the Debtor to Glenn Schwartz, it was made in a May 1, 1997 letter from the Debtor's attorney to Judge Murphy requesting that he direct the liquidation of the parties' IRAs to prevent the foreclosure sale, and the Debtor was bound by that letter for purposes of Section 523(a)(2)(A); (3) the Debtor made the false representation to Glenn Schwartz with the intent to deceive him because she never liquidated her IRA account pursuant to the IRA Order, and, given the proximity of the letter from her attorney to Judge Murphy, the IRA Order and the auction sale, she could never have intended at the time the false representation was made to liquidate her IRA accounts and

pay the proceeds to Chase; (4) Glenn Schwartz relied on the Debtor's false representation, as evidenced by the fact that he did liquidate his IRA accounts and was prepared to pay them over to Chase in order to reinstate the Chase Mortgage and stop the foreclosure sale, however, because the Debtor failed to comply with the IRA Order and appear at the foreclosure sale to pay the proceeds of her accounts to Chase, he never paid the proceeds of his IRA accounts to Chase; and (5) the Deficiency Debt was the direct result of the Debtor's failure to liquidate her IRA accounts and pay the proceeds over to Chase which would have reinstated the Chase Mortgage on the Apartment and stopped the foreclosure sale, since if she had complied with the IRA Order, the Chase Mortgage would have been reinstated and the parties could have sold the Apartment for a profit, or, even if she had timely advised Glenn Schwartz that she was not going to comply with the Order, he could have otherwise made arrangements to reinstate or payoff the Mortgage and prevent any deficiency.

Although I cannot condone the Debtor's failure to comply with the IRA Order, I find that Glenn Schwartz has failed to prove the required elements of actual fraud under Section 523(a)(2)(A), by a preponderance of the evidence, so that any debt or obligation which the Debtor might otherwise have had to

him should he be required to pay more than one-half of the Deficiency Debt,is dischargeable.

A. Representation; Falsity

There is insufficient evidence in the record for the Court to conclude that the Debtor actually made a false representation to Glenn Schwartz about the liquidation of her IRA accounts and the payment of any proceeds to Chase. Exhibit 3, filed on behalf of Glenn Schwartz at the time the Adversary Proceeding was submitted for decision, is a copy of a July 25, 2000 deposition of Alison Schwartz (the "Schwartz Deposition"). A review of Pages 13-27 of the Schwartz Deposition indicates that the Debtor did not have any direct discussions with Glenn Schwartz regarding her IRA accounts and the Chase Mortgage and did not instruct her attorney to recommend to Judge Murphy that he enter the IRA Order. Rather, the Schwartz Deposition indicates that, as often is the case in divorce actions, the parties are musicians in an ever-changing symphony performance written and conducted by their attorneys. Therefore, I find that Glenn Schwartz has failed to prove by a preponderance of the evidence that the Debtor made a false representation.

B. Scienter

It is also clear from Pages 13-27 of the Schwartz Deposition that to the extent that a false representation may have been made to Glenn Schwartz regarding the IRA accounts and the payment of the proceeds to reinstate the Chase Mortgage, the Debtor did not in any way participate in that representation with an intent to deceive him.

C. Justifiable Reliance

I find that Glenn Schwartz did not justifiably rely on the provisions of the IRA Order. There is no evidence in the record that Chase would have allowed the Chase Mortgage to be reinstated on the date of auction sale by the payment of all arrearages due on the Mortgage along with attorneys' fees and expenses, or that the proceeds of the IRA accounts of Glenn Schwartz and the Debtor would have been sufficient to pay all of those amounts necessary if Chase elected to allow the Mortgage to be reinstated. Since a Judgment of Foreclosure and Sale had been entered by the New York State Supreme Court, Chase had the option of requiring the full payment of all of the amounts due on the Mortgage. If the Mortgage was to have been paid off or reinstated, there would have had to have been extensive discussions among representatives of Chase, Glenn Schwartz and

the Debtor to insure that there was an ability to pay off or reinstate the Chase Mortgage. However, there is no evidence in the record that any such discussions took place. Furthermore, if there was to be a payoff or reinstatement of the Mortgage, at some point well before the day of the auction sale, representatives of Glenn Schwartz would have contacted representatives of the Debtor to: (1) insure that her IRA accounts had been liquidated; (2) determine the exact amount of the proceeds available from her accounts; and (3) attend to all of the other details necessary so that the Chase Mortgage could be paid off or reinstated. There is no evidence in the record that such contacts were made by or on behalf of Glenn Schwartz.

Therefore, I find that Glenn Schwartz could not have justifiably relied on the terms of the IRA Order with respect to the payoff or reinstatement of the Chase Mortgage.

D. Damage

Glenn Schwartz was contingently liable, along with the Debtor, for the full amounts due or to become due on the Chase Mortgage, which was already in default and had been accelerated at the time of the entry of the IRA Order. Since there is no evidence in the record from which I can conclude that Chase would have permitted the Chase Mortgage to have been reinstated

on the date of the auction sale, or that the proceeds of the liquidation of the IRA accounts of Glenn Schwartz and the Debtor would have been sufficient to pay all of the amounts necessary to reinstate the Mortgage, I must find that Glenn Schwartz has failed to meet his burden to prove that the Deficiency Debt was the direct result of the Debtor's failure to comply with the IRA Order.

As I have previously stated, there would have been detailed discussions among representatives of Chase, Glenn Schwartz and the Debtor to insure that the Chase Mortgage could have been reinstated or paid off on or before the date of the auction sale, and there is no evidence in the record that Glenn Schwartz or his representatives took the necessary steps to insure that everything necessary was in place to result in a reinstatement or payoff. Therefore, the Debtor's failure to comply with the IRA Order was not the proximate cause of Glenn Schwartz's liability for the Deficiency Debt.

IV. Section 523(a)(6)

The Court is unclear from the pleadings whether by the time of trial Glenn Schwartz was still asserting that the failure of the Debtor to comply with the IRA Order made any liability she might have to him in connection with the Deficiency Debt

nondischargeable pursuant to Section 523(a)(6) because her actions were wilful and malicious. The United States Supreme Court in *Kawaauhau v. Geiger*, 523 U.S. 57 (1998), has held that for a plaintiff to prevail on a cause of action under Section 523(a)(6) for wilful and malicious injury, it must demonstrate, by a preponderance of the evidence, that the debtor intended to cause a particular injury, rather than that a debtor's deliberate act merely lead to the injury.

Glenn Schwartz has failed to prove, by a preponderance of the evidence, that the Debtor's failure to comply with the IRA Order was done by her with the intent to cause him the alleged injury, to wit, making him liable for a deficiency on the Chase Mortgage after the auction sale, which he would not otherwise have been liable for.

CONCLUSION

The Debtor is discharged from any liability to Glenn Schwartz in connection with the Deficiency Debt.

IT IS SO ORDERED.

BK. 898-80437-478
AP. 800-8054-478

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HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE

Dated: February 12, 2001