
In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:)
)
PENNY FOXWORTH SMITH) Adversary Proceeding
(Chapter 7 Case Number 94-40776)) Number 94-4116
)
Debtor)
)
)
FARMERS & MERCHANTS BANK)
)
Plaintiff)
)
)
)
v.)
)
PENNY FOXWORTH SMITH)
)
Defendant)

ORDER DISMISSING ADVERSARY PROCEEDING

This adversary action was filed September 23, 1994, captioned "Complaint Objecting to Discharge." Specifically, the Plaintiff asked that the Debtor be denied her general discharge because she had allegedly violated 11 U.S.C. Section 727(a) by disposing of property pledged to the Plaintiff without remitting the proceeds to the Plaintiff. On

October 25, 1994, Debtor filed an Answer alleging in material part that the property was sold with the Plaintiff's permission and that the proceeds of the sale were delivered to and accepted by the Plaintiff.

On January 3, 1995, the Plaintiff filed a notice of taking deposition of the Defendant, and the examination of the Defendant presumably transpired on January 6, 1995. Shortly thereafter on February 1, 1995, Plaintiff filed a dismissal without prejudice of the adversary proceeding and on the same date the Clerk issued a notice advising creditors and the Trustee of the Plaintiff's proposed dismissal. The notice required any party in interest with an objection to the dismissal of the adversary to notify the Clerk not later than February 22, 1995, and scheduled a hearing to consider the dismissal and any objections thereto for March 8, 1995. On March 8, neither Plaintiff's nor Debtor's counsel appeared, but the Chapter 7 Trustee appeared and advised the Court that he had not been made aware of any objection. Indeed the Court received no written objection to the proposed dismissal. Because of the special concerns which arise when a complaint objecting to the general discharge of the debtor is to be dismissed, however, I questioned the Trustee regarding the degree to which he had investigated the circumstances surrounding the dismissal and concluded, based on his response, that the case should be dismissed.

Because there appears to be uncertainty regarding the duty of disclosure

surrounding, and the procedures to be followed, in seeking dismissal of Section 727 actions, I hereby elaborate on my conclusions.

Bankruptcy Rule 7041 provides as follows:

Rule 41 F.R.Civ.P. applies in adversary proceedings, except that a complaint objecting to the debtor's discharge shall not be dismissed at the plaintiff's instance without notice to the trustee, the United States trustee, and such other persons as the court may direct, and only on order of the court containing terms and conditions which the court deems proper.

Clearly, the rulemakers have determined that when a complaint objecting to the debtor's discharge is filed, the plaintiff shall not be permitted to voluntarily dismiss without notice and approval of the court. Since there are no statutory standards governing the Court's decision on the proposed dismissal, I construe the statute to vest discretionary authority in the Court to determine whether, and on what terms, dismissal is appropriate. While no opinion can exhaustively treat the many factors which may affect the court's decision regarding dismissal, there are many which are relevant.

The first is whether another creditor has elected not to file an objection because of the pendency of the action which is to be dismissed. Allowing dismissal of a

section 727 action without notice to all creditors and to the trustee unfairly prejudices any creditor which has relied on the pendency of a section 727 action in electing not to file such an action. Upon receiving notice of a proposed dismissal, such creditor may timely seek to intervene and prosecute it to conclusion. Thus Rule 7041 requires that notice of the proposed dismissal be provided to all parties in interest, and the Court must consider at a hearing whether the Trustee or any creditor wishes to pursue the action.

The second is whether consideration will be paid to the objecting creditor in exchange for dismissal of the complaint objecting to the discharge. The payment of consideration raises at least two distinct problems in the Section 727 context. If in fact the debtor has committed an act which should lead to a denial of discharge under section 727, then all creditors are entitled to and should expect to be treated equally, and all claims should be determined nondischargeable rather than only the claim of the creditor who initiated the action. If the creditor which brings the action receives repayment of a portion or all of its claim, while other creditors' claims are discharged, it will have been unfairly benefited. On the other hand, a debtor facing a general denial of discharge may be coerced into a settlement with the one objecting creditor in order to guarantee receipt of the discharge, even if the merits of the objection are weak. Thus Rule 7041 gives the Court the power to condition or limit the terms of the dismissal, and it is incumbent on the Court to determine whether any consideration is being paid, directly or indirectly, at a hearing.

Because of these special considerations, it is improper for a section 727 action to be dismissed without a full disclosure of the consideration, if any, being received in exchange for a dismissal and without notice giving the trustee and all creditors the opportunity to take up the burden of prosecuting the section 727 action. In order to meet the burden imposed by Rule 7041, I conclude that no dismissal can be approved without counsel for the parties making full disclosure of the circumstances underlying the dismissal, at a hearing after notice, and responsibility for monitoring full disclosure is vested in the United States Trustee or the case trustee, as appropriate under 11 U.S.C. Section 704(6) and 28 U.S.C. Section 586(a)(1).

Notwithstanding the circumstances in which dismissal of a Section 727 action is improper, there are, in fact, many times when a dismissal is appropriate. In many cases, although there is a good faith belief that the objection is well-founded when the action is filed, the creditor learns through subsequent discovery that it cannot in good faith prosecute the action. In other cases, the complaint has been inartfully drafted and the gravamen of the complaint is that the debtor has committed an act which would except the particular claim from discharge under section 523, without affecting the debtor's entitlement to a general discharge. Still in other cases, actions are brought where both sections are referenced in the pleadings or indeed where only section 727 is referenced in the pleadings where, in reality, the act complained of fits only under section 523. If the Court is satisfied

that the case in fact, does not merit further prosecution, or that it should properly have been brought as a section 523 action, it is appropriate to allow dismissal on Plaintiff's motion.

In any event the court must be fully informed as to the underlying circumstances for the dismissal. To satisfy this burden, it is mandatory that plaintiff's counsel appear at the hearing set to consider the motion to dismiss in order to establish on the record the reasons underlying the motion to dismiss and to respond to any appropriate inquiry by the trustee, creditors, or the Court. It is also incumbent, under the provisions of 11 U.S.C. Section 704(6), that the trustee affirmatively respond, in person or by appropriate pleading, to the motion to dismiss and show (1) that the trustee is aware of the proposed dismissal; (2) that the trustee has investigated whether any consideration has been given in exchange for dismissal; (3) whether the trustee wishes to intervene and prosecute the section 727 action; and (4) if not, to state the basis on which the action does not merit further prosecution, whether because the action actually seeks section 523 relief, or because the facts do not meet the burden of proof necessary to prevail, or other reasons.

In the case before me, the appropriate notice has been sent and neither the Trustee nor any creditor has requested the right to intervene and proceed. The Trustee has examined the underlying facts in the section 727 action and has satisfied himself that there has been no consideration given and that the facts as uncovered by Plaintiff's counsel during

discovery did not support the continued prosecution of a section 727 action.

Accordingly, under the rationale of this Order and because notice was given to all parties in interest, none of whom objected, I conclude that the case should be and the same is hereby dismissed.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of April, 1995.