

The *Reinhart* Saga Continues: Impact of a Guarantor's Bankruptcy Discharge on Future Liability Under Guaranty



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Obtaining a personal guaranty from a customer's owner or principal can be a very powerful collection tool for trade creditors looking to backstop obligations owed by the customer. However, a personal guaranty is only as good as the person who provides it. In some instances, a personal guarantor may face financial distress that ultimately causes the guarantor to file for bankruptcy.

Courts have reached different conclusions as to the impact of a personal guarantor's discharge on future liability under a guaranty. In *Reinhart Food Service L.L.C. v. Schlundt*, the United States Bankruptcy Court for the Eastern District of Wisconsin (the "Bankruptcy Court") held that a personal guarantor's bankruptcy discharges not only claims under the guaranty that existed on the date of the guarantor's bankruptcy filing, but also future claims that may arise under the guaranty after the bankruptcy filing. The Bankruptcy Court largely relied on precedent it believed had been established by the United States Court of Appeals for the Seventh Circuit (the "Seventh Circuit").

The creditor appealed the *Reinhart* decision to the United States District Court for the Eastern District of Wisconsin (the "District Court"), and, fortunately for the



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trade, the District Court reversed the Bankruptcy Court's decision on appeal. The District Court held that a claim under a guaranty that did not exist before a guarantor's bankruptcy filing cannot be subject to the guarantor's discharge.

But the final chapter of the *Reinhart* saga is yet to come. The debtor has appealed the District Court's decision, thereby giving an opportunity for the Seventh Circuit to weigh in.

Background Regarding the Reinhart Case

From 2003 to 2018, David Schlundt ("Schlundt") was the owner and sole member of The Refuge, LLC ("The Refuge"), a restaurant in Antigo, Wisconsin. On Sept. 11, 2003, The Refuge entered into a supply agreement (the "Supply Agreement") with Reinhart Foodservice, L.L.C. ("Reinhart") for Reinhart to provide food and restaurant

supplies to The Refuge. Within that same document, Schlundt executed an absolute, continuing and irrevocable Individual Personal Guaranty (the "Guaranty"). Pursuant to the Guaranty, Schlundt agreed to be personally liable for all indebtedness—"whether now existing or hereinafter incurred"—that The Refuge owed to Reinhart under the Supply Agreement.

Approximately ten years later, Schlundt and his wife (collectively, the "Debtors") jointly filed a Chapter 7 bankruptcy petition. As of the petition date, The Refuge owed \$10,000 to Reinhart for goods and services The Refuge had purchased from Reinhart. Although this indebtedness was subject to the Guaranty, the Debtors did not list Reinhart as a creditor on their bankruptcy schedules or creditor matrix and, as a result, Reinhart did not receive any official notice of the bankruptcy filing. On April 11, 2014, the Chapter 7 trustee issued a report of no distribution (*i.e.*, it was a no asset case) and on April 21, 2014, the Debtors received a discharge of their indebtedness pursuant to section 727 of the Bankruptcy Code.

The Refuge continued to operate and do business with Reinhart under the Supply Agreement for several years after the Debtors' bankruptcy filing and discharge, until The Refuge eventually ceased operating in 2018. When The Refuge closed its business, The Refuge owed approximately \$37,000 to Reinhart on account of goods and services The Refuge had purchased from Reinhart from March 2018 to May 2018. In light of The Refuge's non-payment, Reinhart demanded payment from Mr. Schlundt under the Guaranty. Schlundt refused, relying on the 2014 bankruptcy discharge.

Reinhart moved to reopen the Debtors' bankruptcy case without opposition, and filed a complaint seeking to enforce the Guaranty to obtain payment of The Refuge's unpaid debt incurred in 2018. Reinhart moved for summary judgment, seeking a determination that the Debtors' 2014 discharge did not cover post-petition and post-discharge obligations under the Guaranty with respect to the goods and services Reinhart had sold on credit to The Refuge in 2018. In response, the Debtors

moved for summary judgment, arguing that their 2014 discharge extinguished the Guaranty and all personal liability to Reinhart thereunder because any debt under the Guaranty arose in 2003—when Mr. Schlundt had executed the Guaranty.

The Bankruptcy Court's Decision

The Bankruptcy Court granted summary judgment in favor of the Debtors, holding that their 2014 bankruptcy discharge had extinguished all indebtedness under the Guaranty, including future indebtedness. The Bankruptcy Court considered whether the Guaranty had created a contingent prepetition claim that was discharged in the Debtors' 2014 bankruptcy case, or gave rise to a post-petition claim based on the credit Reinhart had extended to The Refuge in 2018 that did not exist before (and, therefore, was not discharged in) the Debtors' 2014 bankruptcy case.

The Bankruptcy Court noted a division in authority regarding whether the "accrual approach" or the "conduct test" determines when a claim has arisen in relation to a bankruptcy proceeding. Courts that have applied the accrual approach have held that state law determines when a claim arises.

However, the Bankruptcy Court applied the conduct test and rejected the accrual approach because the conduct test had previously been adopted by the Seventh Circuit, the decisions of which are binding on the federal courts in Illinois, Indiana and Wisconsin (where the Reinhart court sits). In the 2015 decision of *Saint Catherine Hosp. of Ind., LLC v. Ind. Family and Soc. Servs. Admin.*, the Seventh Circuit held that whether a claim arises prepetition or post-petition depends on the date of the conduct that gave rise to the claim. The Seventh Circuit and other courts following the conduct test have noted that the policy goals underlying Bankruptcy Code are best served by finding that a claim arises "at the earliest point possible." According to the "conduct test," the conduct that gives rise to a claim under a contract is generally the act of signing the contract.

Holding that it was bound by the Seventh Circuit's holding in *Saint Catherine*, the Bankruptcy Court concluded that Reinhart's

claim under the Guaranty had arisen when Mr. Schlundt had executed the Guaranty in 2003. Accordingly, the Bankruptcy Court held that the Guaranty claim was a contingent and unliquidated prepetition claim that existed when the Debtors had filed their bankruptcy case in 2014 and, therefore, was extinguished by the discharge granted to the Debtors in the bankruptcy case. Reinhart appealed the decision to the District Court.

The District Court's Decision

The District Court reversed the Bankruptcy Court's decision, holding that the 2014 bankruptcy did not result in the discharge of obligations under the Guaranty relating to The Refuge's purchases of goods and services from Reinhart in 2018. The District Court noted that Bankruptcy Code Section 727(b) discharges Chapter 7 debtors from "all debts that arose before the date of the order for relief [*i.e.*, the date of the bankruptcy petition]." Section 101(12) defines a "debt" as a liability on a claim, and section 101(5)(A) defines a claim as "a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." The District Court concluded that, according to these sections, the Debtors' discharge applied only to any right to payment that arose prior to the Debtors' 2014 bankruptcy filing. Reinhart's right to payment of the approximately \$37,000 at issue arose in 2018, when The Refuge failed to pay for goods and services purchased on credit from Reinhart, thereby triggering the right to payment under the Guaranty.

The District Court rejected the Debtors' argument, and the Bankruptcy Court's holding, that any future debts associated with the Guaranty arose before the Debtors' 2014 bankruptcy filing. As the District Court reasoned, "the mere existence of a promise or a contract does not necessarily create a legal liability [; n]or does a bankruptcy discharge automatically wipe away all of a debtor's pre-bankruptcy contracts or contractual promises." The District Court drew a compelling analogy: if a debtor contracts for a line of credit and later obtains a bankruptcy discharge, the debtor "is not free to go on a post-bankruptcy spending spree . . . drawing on that line of credit and

then have these new post-petition liabilities declared discharged.”¹

The District Court also relied on Wisconsin law that treats each extension of credit under a continuing guaranty as a separate liability. The District Court also noted that other states’ law supports this view.


The District Court also disagreed with the Bankruptcy Court’s application of the Seventh Circuit’s opinion in *Saint Catherine*. The claim at issue in *Saint Catherine* was based on a prepetition assessment levied by a government agency to provide funding to reimburse hospitals for their treatment of Medicaid patients. The assessment was to be paid in two installments. The debtor had filed for bankruptcy protection prior to paying the second installment, but the Seventh Circuit held that the agency’s claim for the amount owed via the second installment was a prepetition debt in any event, since the conduct giving rise to the claim (i.e., the assessment) was known and had occurred before the bankruptcy filing.

In contrast, as the District Court concluded, the claim under the Guaranty arising from The Refuge’s purchases from Reinhart in 2018 did not exist when the Debtors filed their bankruptcy petitions in 2014. While the Guaranty itself existed, the actual conduct that gave rise to the liability—i.e., Reinhart’s provision of goods and services on credit to The Refuge from March to May 2018—occurred after the bankruptcy filing and discharge. Bottom line, unlike the creditor or debtor in *Saint Catherine*, neither Reinhart nor the Debtors could have possibly known before the Debtors’ bankruptcy filing that additional liabilities would be incurred by The Refuge and triggered under the Guaranty in 2018.

The District Court held that the general principle (on which the Bankruptcy Court partially relied) that claims should typically be deemed to have arisen at the earliest possible moment did not apply in the *Reinhart* case. This general principle is supposed to prevent a party that knows it has a claim from withholding its claim so that it may pursue the claim at a more advantageous time after the bankruptcy. Here, Reinhart did not have any right to payment that could have been accounted

for in the Debtors’ 2014 bankruptcy case. The right to payment arose long after the bankruptcy case, when Schlundt’s company, The Refuge, chose to obtain additional goods and services on credit from Reinhart in 2018 that were subject to the continuing Guaranty. As the District Court stated, “[t]here is nothing onerous or unfair about holding [Schlundt] to that bargain based on his own post-bankruptcy conduct.”

Conclusion

The District Court’s holding is surely a promising sign for creditors relying on personal guaranties to backstop payment of their claims against their customers. However, the *Reinhart* saga is not over yet, since Schlundt has appealed the District Court’s decision to the Seventh Circuit. In the meantime, creditors should continue to be mindful of the risk that a guarantor’s bankruptcy filing and discharge may potentially extinguish all future claims under an existing guaranty. If a creditor’s guarantor has filed for bankruptcy protection, the creditor should condition any further extensions of new credit to the customer on the guarantor’s execution of a new guaranty. 

- 1 The District Court noted that a dischargeable claim could have potentially arisen had Mr. Schlundt terminated the Guaranty before the 2014 bankruptcy filing. A termination of the “irrevocable” Guaranty would have arguably been a breach of that Guaranty, giving rise to a claim for damages arising before the 2014 bankruptcy that would have been discharged as a prepetition debt under Section 727(b).

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