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Does Section 524 (a)(2) of the Bankruptcy Code Bar Criminal Prosecution Concerning Discharged Debts?

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NOTES

DOES SECTION 524(a)(2) OF THE BANKRUPTCY CODE BAR CRIMINAL PROSECUTION CONCERNING DISCHARGED DEBTS?

Because Congress explicitly intended section 524(a)(2) of the Bankruptcy Code¹ to prohibit *any* act to collect debts discharged in bankruptcy,² the provision arguably bars creditors from pursuing criminal prosecution of debtors to aid in their collection efforts. Although bankruptcy law is intended to give a debtor a fresh start, the policy of broadly construing bankruptcy laws to favor a debtor is not meant to protect the dishonest debtor.³ Bankruptcy laws should not be a safe "haven" for criminals.⁴ Thus, section 524(a)(2) presents a tension between potentially conflicting state and federal law and policies.⁵ In balancing the federal bankruptcy policy of affording the debtor a fresh start with a state's right to prosecute debtors who have violated state criminal laws, courts have reached contradictory results.

State criminal prosecution of debtors to coerce collection of unpaid debts is not a recent phenomenon.⁶ Commentators and judges have noted that creditors who are frustrated by the expansive discharge provisions and automatic stay of the Bankruptcy Code have

1. 11 U.S.C. §§ 101-151326 (1982). The Bankruptcy Code comprises all of title 11 of the United States Code.

2. S. REP. NO. 989, 95th Cong., 2d Sess. 80 [hereinafter S. REP. NO. 989], *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5866.

3. *McMillan v. Firestone (In re Firestone)*, 26 Bankr. 706, 719 (Bankr. S.D. Fla. 1982) (citing *Bruning v. United States*, 376 U.S. 358 (1964)).

4. See H.R. REP. NO. 595, 95th Cong., 2d Sess. 342 [hereinafter H.R. REP. NO. 595], *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6299.

5. For a thorough discussion of areas of tension between federal bankruptcy law and state law interests, see Lake, *Conflict: The Bankruptcy Act v. State Statutes*, 10 LOY. L.A.L. REV. 753 (1977).

6. See Cohen, *The History of Imprisonment for Debt and Its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153 (1982).

attempted to use state criminal laws to aid in their collection efforts.⁷

This Note examines whether the policy underlying section 524(a)(2) of the Bankruptcy Code bars the criminal prosecution of debtors in state courts. It first discusses the federal-state conflict that arises when creditors file criminal proceedings in state courts to collect debts discharged under federal bankruptcy law. By examining cases in which debtors have sought to use section 524(a)(2) as a shield against state prosecution, this Note then analyzes the approaches courts have taken to find an equitable balance between federal policy and state interest. This Note concludes that courts should scrutinize the factual circumstances and particular equities of each case in light of certain objective factors to reach a just result. These factors have been expressed by thoughtful courts that have struggled to accommodate the federal interest of providing a fresh start without turning bankruptcy into a haven for criminals and the state and public interest in criminal prosecutions.

THE "FRESH-START" POLICY OF BANKRUPTCY

One of the primary purposes of federal bankruptcy law is to "release the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the allegations and re-

7. See *Whitaker v. Lockert (In re Whitaker)*, 16 Bankr. 917, 922 (Bankr. M.D. Tenn. 1982). Bankruptcy Judge Paine stated that creditor use of the Tennessee bad check statute to collect discharged debts was a "matter of common knowledge" and "ingrained" in the state's criminal justice system. *Id.* For further discussion of state courts acting as debt collection agencies, see Kratsch & Young, *Criminal Prosecution and Manipulative Restitutions: The Use of State Criminal Courts for Contravention of Debtor Relief*, 1984 ANN. SURV. BANKR. L. 107, 108-09. See generally Hendel & Reinhardt, *Inhibiting Post-Petition "Bad-Check" Criminal Proceedings Against Debtors: The Need for Flexing More Judicial Muscle*, 89 COM. L.J. 236 (1984); Kratsch & Young, *supra*, at 107; Mehler, *Criminal Prosecution and Restitution Under the Bankruptcy Code*, 1983 ANN. SURV. AM. L. 817; Ostrow, *The Changing Nature of the Discharge in Bankruptcy*, 1979 ANN. SURV. AM. L. 403; Schutz, *Bankruptcy and the Prosecutor: When Creditors Use Criminal Courts to Collect Debts*, FLA. BAR J., May 1985, at 11. Use of the state criminal process gives rise to three principal concerns: a constitutional dilemma under the supremacy clause, an undermining of the value of the debtor's discharge, and an unfair preference for those creditors who are able to rely on a criminal statute. Kratsch & Young, *supra*, at 109-10.

sponsibilities consequent upon business misfortunes.”⁸ The United States Supreme Court first articulated this “fresh-start” doctrine in *Local Loan Co. v. Hunt*,⁹ in which a federal court enjoined state civil proceedings against a debtor. The Court in *Local Loan* declared that the Bankruptcy Act gave debtors a “new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.”¹⁰ The Court held that the provisions of the Bankruptcy Act should be construed in harmony with this general purpose and policy.¹¹ The fresh-start doctrine retains primary importance in bankruptcy proceedings today.¹²

Problems with Prior Statutory Provisions

Congressional endorsement of the fresh-start policy has been evident in many provisions of federal bankruptcy law. In an effort to strengthen the effectiveness of the discharge in bankruptcy, in 1970 Congress passed section 32(f), which provides in part: “An order of discharge shall . . . enjoin all creditors whose debts are discharged from thereafter instituting or continuing any action or employing any process to collect such debts as personal liabilities of the bankrupt.”¹³

Congress’s primary goal in passing this legislation was to prevent creditors from harassing bankrupt debtors.¹⁴ Section 32(f) pur-

8. *Williams v. United States Fidelity and Guar. Co.*, 236 U.S. 549, 554-55 (1915) (quoting *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904)).

9. 292 U.S. 234 (1934).

10. *Id.* at 244.

11. *Cf. id.* at 245 (when such construction is reasonably possible).

12. *See, e.g.* *First Tex. Sav. Ass’n v. Reed (In re Reed)*, 11 Bankr. 683, 685 (Bankr. N.D. Tex. 1981).

13. 11 U.S.C. § 32(f)(2) (1970), amended by 11 U.S.C. § 524(a) (1982).

14. H.R. REP. NO. 1502, 91st Cong., 2d Sess. 2 [hereinafter H.R. REP. NO. 1502], reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS 4156, 4156. The legislation was enacted to attack the problem of creditors bringing suit in state courts after a discharge in bankruptcy had been granted in federal courts. The creditor would hope that the debtor would not appear in the state action, as he often would not, due to misplaced reliance on the bankruptcy discharge, lack of funds to retain an attorney, or improper service. Because the discharge was an affirmative defense that was waived if not pleaded, a default judgment could be entered against the debtor and he could be saddled with a garnishment or lien. *Id.*

ported to give the federal courts exclusive jurisdiction to determine the effect of a discharge when granted.¹⁵

Section 32(f) did not prevent harassment of debtors for discharged debts, however. Several courts interpreted 32(f) to prohibit only legal means of post-discharge debt collection. In *In re Thompson*,¹⁶ the court construed section 32(f) to mean that a bankruptcy discharge did not prevent informal collection practices such as threatening letters and threats of criminal prosecution.¹⁷ The United States District Court for the Southern District of Texas noted that the debt collection methods contravened the fresh start purpose of the Bankruptcy Act, but found that the creditors could not be "held in technical contempt of the bankruptcy court's discharge order."¹⁸ In upholding lower court decisions, the United States Court of Appeals for the Eighth Circuit also has found that the 1970 amendments did not prohibit nonlegal, informal means of inducing a debtor to make payments on discharged obligations.¹⁹ The Eighth Circuit stated that the word "process" in section 32(f) implied court action and the "activation of the formal legal machinery of a government."²⁰

Enactment of Section 524(a)(2)

Although not all courts interpreted the provision as technically as the court in *Thompson*,²¹ Congress, in the Bankruptcy Reform Act of 1978, enacted section 524(a)(2)²² to replace section 32(f)(2).

15. H.R. REP. NO. 1502, *supra* note 14, at 2, reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS at 4156-57.

16. 416 F. Supp. 991 (S.D. Tex. 1976).

17. *Id.* at 996. The court in *Thompson* relied on legislative history stating that § 32(f) was to eliminate "harassment lawsuits" in state courts. *Id.* (citing Bankruptcy Act Amendments, 116 CONG. REC. 34,818, 34,818-20 (1970)).

18. *Id.*

19. See *Girardier v. Webster College*, 563 F.2d 1267, 1272 (8th Cir. 1977).

20. *Id.* at 1272-73.

21. See, e.g., *In re Penny*, 414 F. Supp. 1113, 1115 (W.D.N.C. 1976) (staying criminal proceedings initiated to collect debts was the only way to effectuate judgments of the bankruptcy court).

22. 11 U.S.C. § 524(a)(2) (1982) states:

(a) A discharge in a case under this title

. . . .

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect, recover, or offset

The purpose of section 524(a)(2) was to accord complete relief to debtors.²³ By insuring that once a debt was discharged, the debtor would not be pressured to repay it,²⁴ the House intended section 524(a)(2) to eliminate any doubt concerning the effect of the discharge as a total prohibition on debt collection efforts.²⁵ Section 524(a)(2) thus prohibits *any* attempt to collect debts, including pestering telephone calls or letters, harassment, and threats of repossession.

FEDERAL INTERVENTION IN STATE CRIMINAL PROSECUTION

The Younger Abstention Doctrine

When creditors attempt to use state criminal prosecution to collect debts, a debtor often requests a bankruptcy court to issue an injunction to halt the state court proceedings. Congress, however, has limited the power of the federal courts to enjoin state proceedings except in certain limited circumstances.²⁶ In *Younger v. Harris*,²⁷ the Supreme Court recognized one additional basis for the exercise of a federal court's injunctive power. If a person faced with a state criminal prosecution can show that he or she will suffer irreparable damage, a federal court can enjoin the state court proceeding.²⁸

The Court in *Younger* reaffirmed the fundamental policy against federal judicial interference with state criminal prosecutions. This general policy will not be disturbed except under extraordinary circumstances in which the danger of irreparable harm to the crimi-

any such debt as a personal liability of the debtor, or from property of the debtor, whether or not discharge of such debt is waived.

23. *Whitaker v. Lockert (In re Whitaker)*, 16 Bankr. 917, 921 (Bankr. M.D. Tenn. 1982).

24. See H.R. REP. NO. 595, *supra* note 4, at 366, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 6321.

25. See *id.*, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 6321.

26. "[A] court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress or where necessary in aid of its jurisdiction, or to protect or effectuate its judgment." 28 U.S.C. § 2283 (1982).

27. 401 U.S. 37 (1971).

28. *Id.* at 43. The Court in *Younger* stated: "[A] judicial exception to the longstanding policy evidenced by [§ 2283] has been made where a person about to be prosecuted in a state court can show that he will, if the proceeding in the state court is not enjoined, suffer irreparable damages." *Id.* at 43 (citing *Ex parte Young*, 209 U.S. 123 (1908)).

nal defendant is "both great and immediate."²⁹ This threat to the defendant's federally protected rights must be one that he cannot abate by defending against the single criminal prosecution in issue.³⁰ The Court held that in the absence of a "showing of bad faith, harassment, or any other unusual circumstance" to justify the granting of equitable relief, a federal court could not enjoin a criminal prosecution pending in a state court.³¹ In the companion case of *Perez v. Ledesma*,³² the Court elaborated on the *Younger* test by stating that a federal court could enjoin a state criminal prosecution only in cases of "proven harassment or prosecutions undertaken without hope of obtaining a valid conviction and perhaps in other circumstances where irreparable injury can be shown."³³

In the following year, however, the Court announced in *Perez v. Campbell*³⁴ that the supremacy clause invalidated any state legislation that frustrated the full effectiveness of a federal law.³⁵ The

29. *Id.* at 46 (citing *Fenner v. Boykin*, 271 U.S. 240 (1926)).

30. *Id.* An exception to the general rule that a federal court has no jurisdiction to enjoin state criminal proceedings occurs when a state action is brought to enforce an allegedly unconstitutional statute that is the subject matter of a suit already pending in federal court. *Ex parte Young*, 209 U.S. 123, 162 (1908). An injunction was also granted in *Dombrowski v. Pfister*, 380 U.S. 479 (1965), to prevent substantial impairment of freedom of expression resulting from prosecution under an unconstitutionally broad statute. *Id.* at 485-89. The appellants in *Dombrowski* prevailed on their claim that the State of Louisiana was invoking criminal process without any hope of ultimate success, in order to discourage appellants' civil rights activities. The Supreme Court in *Dombrowski* granted injunctive relief because "no readily apparent construction suggests itself as a vehicle for rehabilitating the statute in a single prosecution." *Id.* at 491.

31. *Id.* at 54. Professor Redish maintains that Justice Black's analytical basis for federal court restraint in *Younger*, "Our Federalism," has been justified at various stages of the development of the *Younger* doctrine on four alternative bases of deference: (1) desire to avoid impugning the ability of state courts to meet the obligations imposed on them by the Constitution; (2) avoiding interference with substantive state legislative goals and policies; (3) avoiding interference with the exercise of discretion by state executive officers, especially state prosecutors; and (4) avoiding interference with the orderly operation of state judicial processes. Redish, *The Doctrine of Younger v. Harris: Deference in Search of a Rationale*, 63 CORNELL L. REV. 463, 463-66 (1978).

32. 401 U.S. 82 (1971).

33. *Id.* at 85. The Court did not indicate what "other circumstances" might compel an injunction.

34. 402 U.S. 637 (1971).

35. *Id.* at 652. The Court overruled *Kesler v. Department of Pub. Safety*, 369 U.S. 153 (1961), and *Reitz v. Mealey*, 314 U.S. 33 (1941), two other bankruptcy cases dealing with conflicts between the Bankruptcy Act and state laws. *Id.* at 652.

Court in *Campbell* held invalid under the supremacy clause an Arizona statute providing that a discharge in bankruptcy did not relieve an individual from having his driver's license suspended if he failed to satisfy a judgment resulting from a motor vehicle violation. The Court applied a two-step analysis, first construing the applicable state and federal laws and then determining whether these laws were in actual conflict.³⁶ For the purpose of this determination, the effect of the law, not its stated purpose, was the crucial factor.³⁷ Under this analysis, any state legislation that frustrates the full effectiveness of a federal law is invalid under the supremacy clause. The Arizona statute in question conflicted with the mandate of the Bankruptcy Act, which provided that a discharge in bankruptcy fully discharged all but certain specified judgments.³⁸ The Supreme Court in *Campbell* established that if state law hindered the effective functioning of federal bankruptcy law, the state law would yield. The Supreme Court did not address the *Younger* abstention doctrine, however, which involves federal interference with pending state court proceedings, not state legislation.

The *Younger* abstention doctrine has received extensive and continued criticism.³⁹ Federal courts, however, continue to follow the guidelines of *Younger*⁴⁰ and *Campbell*⁴¹ when a debtor petitions the court asking for an injunction halting state criminal proceedings.

36. *Campbell*, 402 U.S. at 644.

37. *Id.* at 651-52.

38. *See id.* at 649.

39. *See* Redish, *Abstention, Separation of Powers, and the Limits of the Judicial Function*, 94 YALE L.J. 71 (1974). Professor Redish calls for the abolition of total and partial judge-made abstention, arguing that the efficient workings of judicial federalism would not be seriously undermined because courts would still be constrained by existing statutorily dictated abstention and by the limits of the substantive federal rights being enforced. *Id.* at 74-75. *See also* Ziegler, *A Reassessment of the Younger Doctrine in Light of the Legislative History of Reconstruction*, 1983 DUKE L.J. 987. Professor Ziegler contends that *Younger* and its progeny directly contravene the intent of the Reconstruction Congress that adopted the fourteenth amendment. He argues that by declining to exercise their powers, federal courts are neglecting their duty to ensure that state justice systems function in a manner consistent with the requirements of the federal constitution. *Id.* at 988-90.

40. *See* Gilliam v. Metropolitan Gov't, 67 Bankr. 83 (Bankr. M.D. Tenn. 1986).

41. *See In re Hoffman*, 65 Bankr. 985 (D.R.I. 1986); *In re Wengert Transp., Inc.*, 59 Bankr. 226 (Bankr. N.D. Iowa 1986).

The Bankruptcy Court's Power To Stay Criminal Prosecution

The automatic stay provision, 11 U.S.C. § 362,⁴² is one of the federal bankruptcy law's fundamental debtor protections. The stay stops all collection efforts to allow the debtor time to formulate a reorganization plan.⁴³ The stay also protects creditors by preventing an unfair race for the bankrupt's assets and allows additional time for development of an orderly and fair repayment schedule.⁴⁴

In subsection (b) of section 362, Congress specifically listed five exceptions to the automatic stay. Although the proceedings listed in the exceptions are not immune from injunction, Congress stated that for reasons of either policy or practicality, the actions in the enumerated exceptions generally should not be stayed automatically.⁴⁵

42. 11 U.S.C. § 362 (1982) provides:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

43. H.R. REP. NO. 595, *supra* note 4, at 340, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296-97.

44. *See id.* at 341, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296-97.

45. *Id.* at 342, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 6298.

Criminal prosecution of the debtor is one of the exceptions to the automatic stay.⁴⁶ Although criminal prosecution is not automatically stayed, the court may issue an injunction if it determines that a particular action may be "harming the estate."⁴⁷ Further evidence of the bankruptcy court's power to stay criminal prosecution can be found in the legislative history of section 362, which states that "criminal actions *may* proceed in spite of bankruptcy."⁴⁸ Section 362 thus does not prohibit debtors from seeking an injunction against criminal prosecution, but the debtor has the burden of demonstrating the need for an injunction.

Most courts addressing the issue of criminal prosecution of debtors have indicated that the bankruptcy court's authority to proscribe criminal prosecution derives from 11 U.S.C. § 105(a). Section 105(a) states: "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."⁴⁹

Enmeshed in the tension between sections 362(b)(1) and 105(a), is the specific question whether section 524(a)(2) bars criminal prosecution of debtors for discharged debt.⁵⁰ Unlike the automatic stay provisions, section 524 contains no explicit exceptions. This distinction has led some courts to infer that even a criminal proceeding to collect a discharged debt violates section 524.⁵¹ Despite the statutory differences, courts often apply basically the same analytical approach whether the debtor seeks injunctive relief under section 105(a), section 524(a)(2), or both.⁵² Case law overlaps and relevant distinctions between cases are not always clear.

46. Subsection (b) provides: "[T]he filing of a petition under section 301, 302, or 303 of this title . . . does not operate as a stay (1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor." 11 U.S.C. § 362(b).

47. H.R. REP. NO. 595, *supra* note 4, at 342, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 6298.

48. *Id.* (emphasis added), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 6299.

49. 11 U.S.C. § 105(a) (1982).

50. For an informative analysis of the conflict between sections 362(b)(1) and 105(a), see Mehler, *supra* note 7, and Kratsch & Young, *supra* note 7.

51. See, e.g., *Gilliam v. Metropolitan Gov't. (In re Gilliam)*, 67 Bankr. 83 (Bankr. M.D. Tenn. 1986).

52. See, e.g., *Seidleman v. Texas (In re Seidleman)*, 57 Bankr. 149 (Bankr. D. Md. 1986) (applying bad-faith test in considering whether to grant a debtor injunctive relief under § 105(a)); *Bratten v. Sciortino (In re Bratten)*, 55 Bankr. 577 (Bankr. E.D. Va. 1985) (applying

ANALYTICAL APPROACHES TO SECTION 524(A)(2) AND CRIMINAL PROSECUTION

The courts have taken two basic approaches in evaluating debtors' pleas for injunctive relief from state criminal prosecution: a "motivation-based" or "purpose of the prosecution" test and a "bad faith—irreparable harm" standard derived from *Younger*.

The Principal Motivation Test

A court applying the principal motivation test looks to the motivation behind the criminal prosecution. The federal bankruptcy court will not usually interfere with the state criminal process when the criminal prosecution has been instituted primarily to vindicate the rights of the public by punishing criminal conduct or to discourage such conduct by others.⁵³ When the principal motivation is not punishment or prevention but recovery of a discharged debt either by negotiating a plea to a lesser offense in exchange for debt repayment or getting a restitution order after conviction, the bankruptcy court may enjoin prosecution.⁵⁴

In applying the motivation test, courts focus on several objective factors. These include the timing of the prosecution, specifically whether the state initiated the prosecution after the debtor filed a petition in bankruptcy;⁵⁵ the negotiations between the parties, including whether the state informed the debtor charges would be dropped upon payment of the amount owed;⁵⁶ the active interest of

bad-faith—irreparable-harm test when debtor sought injunctive relief on basis of discharge effect of § 524(a)(2)).

53. See *In re Caldwell*, 5 Bankr. 740, 742 (Bankr. W.D. Va. 1980).

54. See, e.g., *Kaping v. Oregon (In re Kaping)*, 13 Bankr. 621 (Bankr. D. Or. 1981). Many courts have also applied the motivation test in § 362(b)(1)-105(a) cases. See *Holder v. Dotson (In re Holder)*, 26 Bankr. 789 (Bankr. M.D. Tenn. 1982); *Wise v. Ritter (In re Wise)*, 25 Bankr. 440 (Bankr. E.D. Va. 1982); *Ohio Waste Servs., Inc. v. Fra-Mar Tires Servs., Inc. (In re Ohio Waste Servs., Inc.)*, 23 Bankr., 59 (Bankr. S.D. Ohio 1982); *Strassmann v. Du-Art Foods, Inc. (In re Strassman)*, 18 Bankr. 346 (Bankr. E.D. Pa. 1982); *Wagner v. Miller (In re Wagner)*, 18 Bankr. 339 (Bankr. W.D. Mo. 1982); *In re Lake*, 11 Bankr. 202 (Bankr. S.D. Ohio 1981); *Reid v. Young (In re Reid)*, 9 Bankr. 830 (Bankr. M.D. Ala. 1981); *In re Caldwell*, 5 Bankr. 740 (Bankr. W.D. Va. 1980); *In re James*, 10 Bankr. 2 (Bankr. W.D.N.C. 1980).

55. See *Salecki v. Virginia (In re Salecki)*, 51 Bankr. 364, 368 (Bankr. E.D. Va. 1985).

56. See *Whitaker v. Lockert (In re Whitaker)*, 16 Bankr. 917 (Bankr. M.D. Tenn. 1982).

the state in pursuing the criminal actions;⁵⁷ and the history of similar proceedings in the area.⁵⁸

In *Kaping v. Oregon*,⁵⁹ the debtor owed over \$16,000 to the State of Oregon for child support payments when he filed his bankruptcy petition in March 1980. On June 19, 1980, the court granted the debtor a discharge in bankruptcy. In April 1980, however, the debtor was indicted for criminal nonsupport.⁶⁰

In attempting to determine the motivation behind the prosecution, the court noted that the arguments of counsel were not particularly helpful in determining the creditor's subjective motivation.⁶¹ The district attorney argued that the case was brought to punish the defendant and deter others, whereas the debtor's attorney argued that the case was brought primarily to recover the already discharged debt for past due support.⁶² Rather than adopting either view of the conflicting evidence, the court examined the sentencing orders in twenty-nine other criminal nonsupport cases. In the overwhelming majority of these cases, the court had ordered restitution rather than jail.⁶³ The court in *Kaping* concluded that the "principal motivation behind prosecutions for criminal nonsupport is to obtain restitution and secondarily to obtain a period of probation to ensure payment of future support as it becomes due."⁶⁴ Because the motivation behind the state prosecution was directly contradictory to the purpose of the federal bankruptcy laws, the court permanently enjoined the state from further criminal prosecution of the debtor.

Critics of the motivation test point to its subjectivity because it lacks a consistent standard that can be applied uniformly.⁶⁵ The court in *Kaping* recognized that any statements by the debtor and

57. See *Salecki*, 51 Bankr. at 368.

58. See *Whitaker*, 16 Bankr. at 922.

59. 13 Bankr. 621 (Bankr. D. Or. 1981).

60. *Id.* at 622.

61. *Id.* at 623.

62. *Id.*

63. Of the 22 cases that did not involve a prior probation violation, all but one ordered payment of past due support (restitution), and only four resulted in jail sentences ranging from 20 days to 4 months. *Id.* at 623.

64. *Id.* at 624.

65. See Kratsch and Young, *supra* note 7, at 119; Mehler, *supra* note 7, at 825.

creditor concerning the purpose of the prosecution would be self-serving and thus of dubious reliability in determining motivation.⁶⁶

The United States Courts of Appeals for the Eleventh and Third Circuits have further undermined the viability of the motivation test by relying on the bad faith—irreparable injury test in cases involving a debtor's efforts to obtain injunctive relief from criminal prosecution under section 105.⁶⁷ Both courts have required the debtor to show either irreparable injury or prosecution in bad faith. The Third Circuit in *Davis v. Sheldon*⁶⁸ specifically rejected the debtor's argument that the inquiry should focus on whether the creditors were motivated by a desire to collect on a discharged debt.⁶⁹ The court in *Davis*, however, noted explicitly that the debtors were not claiming injunctive relief under section 524(a)(2); the court therefore did not address the applicability or scope of that section.⁷⁰ Other courts, however, have used the principal motivation test in construing section 524(a)(2).⁷¹

The Bad Faith—Irreparable Harm Test

The second approach courts have taken when asked to enjoin criminal prosecution by a debtor derives from the Supreme Court's decision in *Younger v. Harris*.⁷² Under this approach, a court will enjoin a criminal prosecution only if the debtor shows that the prosecutor initiated the criminal proceeding in bad faith or if the debtor will suffer irreparable injury from the criminal proceeding.⁷³

66. *Kaping*, 13 Bankr. at 622.

67. See *Davis v. Sheldon* (*In re Davis*), 691 F.2d 176 (3d. Cir. 1982); *Barnett v. Evans*, 673 F.2d 1250 (11th Cir. 1982).

68. 691 F.2d 176 (3d. Cir. 1982).

69. *Id.* at 178.

70. *Id.* at 179 n.8.

71. See *In re Goodman*, 34 Bankr. 23 (Bankr. D. Or. 1983). The court held a creditor in contempt for causing the arrest of a debtor after discharge because the creditor knowingly and intentionally violated §§ 362(a)(6) and 524(a)(2). *Id.* at 276. See also *Salecki v. Virginia* (*In re Salecki*), 51 Bankr. 364 (Bankr. E.D. Va. 1985). In *Salecki*, Bankruptcy Judge Shelley acknowledged that the United States District Court for the District of Maryland had over-turned a bankruptcy court's application of the principal motivation test in *Taylor v. Widowson* (*In re Taylor*), 44 Bankr. 548 (D. Md. 1984), *rev'g* 16 Bankr. 323 (Bankr. D. Md. 1981), but stated that under either test no injunction was required by the circumstances. *Salecki*, 51 Bankr. at 367 n.5.

72. See *supra* notes 27-41 and accompanying text.

73. See *Wilson v. Estes* (*In re Wilson*), 30 Bankr. 91, 98 (Bankr. E.D. Tenn. 1983).

The focus shifts from the creditor's motivations to the prosecutor's intent. A defendant can show bad faith when a prosecuting attorney has reason to doubt the validity of the charges, when he fails to exercise independent judgment in continuing the prosecution, or when the complaining witness has insufficient evidence to support the allegation.⁷⁴ This approach has also been criticized as being subjective and susceptible to widely disparate interpretations regarding what constitutes bad faith and irreparable harm.

Many courts have followed this approach in deciding whether to grant injunctive relief to a debtor under section 105.⁷⁵ The acceptance of this approach by the Third and Eleventh Circuits may portend a trend toward the acceptance of the bad-faith test over the motivation approach.⁷⁶

The bankruptcy court in *In re Allman*⁷⁷ stated that a federal court should not enjoin a criminal proceeding merely because the action concerned a debt that had been discharged in bankruptcy proceedings. The court in *Allman* considered both the primary motivation and bad-faith prosecution tests and adopted the latter approach. Relying principally on the Third Circuit's opinion in *Davis*⁷⁸ and the Eleventh Circuit's decision in *Barnett v. Evans*,⁷⁹ the bankruptcy court stated that the bad-faith prosecution test was the better view for three reasons. First, the approach in *Davis* recognized the valid state interests in a criminal prosecution and acknowledged that a federal court could not shield a debtor from a

74. *Allman v. Merit Brass Co. (In re Allman)*, 43 Bankr. 840, 848 (Bankr. D. Colo. 1984).

75. See, e.g., *Davis v. Sheldon (In re Davis)*, 691 F.2d 176 (3d. Cir. 1982); *Barnett v. Evans*, 673 F.2d 1250 (11th Cir. 1982); *Tenpins Bowling, Ltd. v. Alderman (In re Tenpins Bowling)*, 32 Bankr. 474 (Bankr. M.D. Ga. 1983); *Lare v. Norton (In re Lare)*, 24 Bankr. 959 (D. Md. 1982). But see *Richardello v. Garrick (In re Richardello)*, 28 Bankr. 344 (Bankr. D. Mass. 1984); *Trail West, Inc. v. South Dakota*, 17 Bankr. 330 (Bankr. D.S.D. 1982).

76. See, e.g., *Seidleman v. Texas (In re Seidleman)*, 57 Bankr. 149 (Bankr. D. Md. 1986); *In re Jerzak*, 47 Bankr. 771 (Bankr. W.D. Wis. 1985); *Frances v. Reno (In re Frances)*, 44 Bankr. 1016 (Bankr. S.D. Fla. 1984); but see *Hansen v. Washington (In re Hansen)*, 48 Bankr. 107 (Bankr. W.D. Wash. 1985) (applying primary motivation test).

77. 43 Bankr. 840 (Bankr. D. Colo. 1984).

78. See *supra* notes 62-64 and accompanying text.

79. 673 F.2d 1250 (11th Cir. 1982). Circuit Judge Roney stated that 11 U.S.C. § 105(a) did not give a bankruptcy court the authority to ignore the principles of *Younger v. Harris*. The court was not concerned that one effect of conviction and imposition of restitution was the collection of a discharged debt. Rather, the court focused solely on the *Younger* test to determine whether an abuse of the criminal process had occurred. *Id.* at 1251-52.

good-faith prosecution.⁸⁰ Second, the *Davis* approach allowed a bankruptcy court to recognize that a state court would not ignore the protection of the debtor in bankruptcy, but would fashion relief that would protect the debtor's rights to discharge debts.⁸¹ Finally, this approach limited the intervention of federal courts in state court proceedings to situations in which a bad-faith prosecution could be shown.⁸²

The bad-faith test has been criticized as being "simply ineffectual in bringing about the protection of debtor's rights."⁸³ The court's application of the bad-faith test in *Wilson v. Estes (In re Wilson)*⁸⁴ to determine whether to grant injunctive relief to a debtor under section 524(a)(3) supports this criticism. A hearing in January 1983 revealed that the State of Tennessee had had little or no interest in criminally prosecuting the debtor and had appointed the creditor's attorney as a special prosecutor to pursue the case.⁸⁵ A letter from the special prosecutor/creditor's attorney, in response to a proposed settlement by the debtor's attorney, provided further evidence that the creditor was using the criminal prosecution as a debt collection device.⁸⁶

Despite the state's lack of interest in pursuing the criminal prosecution, the appointment of creditor's attorney as a special prosecutor, and the evidence that the criminal prosecution would have been suspended if Wilson had tendered payment for his discharged debt, the bankruptcy court in *Wilson* refused to find bad faith on the part of the prosecution. Instead, the court relied on an affidavit

80. *In re Allman*, 43 Bankr. 840, 846 (Bankr. D. Colo. 1984).

81. *Id.*

82. *Id.*

83. Kratsch and Young, *supra* note 7, at 118.

84. 30 Bankr. 91 (Bankr. E.D. Tenn. 1983). The debtor, Wilson, filed for bankruptcy in late May 1980. In July 1980, creditors filed a criminal complaint against Wilson, seeking to except from Wilson's discharge in bankruptcy the aggregate amount of the mechanics' and materialmen's liens filed by Wilson's subcontractors against their property. The creditors allegedly had paid Wilson \$34,000 for construction of a home; however, only a portion of the amount paid was used for construction work, giving rise to the liens against the creditors' property. Wilson's motion for summary judgment was granted on July 27, 1981. The bankruptcy court granted Wilson a discharge on September 23, 1981. *Id.* at 93-94.

85. *Id.* at 94.

86. The letter stated, "In accordance with our conversation of February 17, 1982, I must reject your offer of \$7,000. . . . If Mr. Wilson could come up with \$6,600 more, the case can be resolved." *Id.* at 95.

from a state prosecutor stating that the action was not an attempt to collect a civil debt.⁸⁷ Certainly the state prosecutor had "reason to doubt the validity of the charges" and perhaps failed to "exercise independent judgment in continuing the prosecution."⁸⁸ In another Tennessee case, the bankruptcy court in *Whitaker v. Lockert* (*In re Whitaker*)⁸⁹ ruled that although the prosecution of the debtor was not in bad faith, continuation of the criminal action would result in irreparable harm to the debtor.⁹⁰ In *Whitaker*, the creditor initiated criminal proceedings against the debtor sixteen months after the debtor had written bad checks and three months after the debtor had received a discharge from debts. The court held that by its language, section 524(a)(2) prohibited the creditor from receiving any payment of the discharged debt as a result of a criminal proceeding.⁹¹ The court noted that the purpose of section 524(a)(2) was to "accord complete relief."⁹² Allowing payment of a discharged debt as a result of criminal prosecution would defeat this purpose and hinder the debtor's fresh start in bankruptcy.

The bankruptcy court in *Whitaker* distinctly separated the questions of issuing injunctions against the creditor and against the state. The state criminal prosecution was not enjoined on the basis of section 524(a)(2). Rather, the court applied the test enunciated in *Younger* and determined that the debtor would suffer irreparable injury as a result of the criminal prosecution. The court reasoned that because section 524(a)(2) prohibited the creditor

87. The affidavit stated in part:

Given the nature of defendant's crime, I determined that restitution was a proper and necessary element in any pretrial diversion program for defendant. That decision was not an attempt to collect a civil debt from defendant, for any party, but was rather an attempt to impose conditions showing defendant's suitability for a diversion program. It was felt that if defendant would escape criminal prosecution through a diversion program, than [sic] defendant should show his willingness to correct the wrongful effects of his actions.

Id. at 97-98.

88. See *Allman v. Merit Brass Co.* (*In re Allman*), 43 Bankr. 840 (Bankr. D. Colo. 1984); *supra* text accompanying note 68.

89. 16 Bankr. 917 (Bankr. M.D. Tenn. 1982).

90. *Id.* at 922.

91. *Id.* at 921.

92. *Id.* (citing *Layfield v. Director of Pub. Safety* (*In re Layfield*), 12 Bankr. 846 (Bankr. N.D. Ala. 1981)). See *University of Alabama Hosps. v. Warren* (*In re Warren*), 7 Bankr. 201 (Bankr. N.D. Ala. 1980).

from receiving any payment on the discharged debt, the statute precluded the state from striking a deal whereby the criminal charge would be dropped upon payment of the debt. The court stated:

These circumstances effectively place the debtor between the proverbial 'rock and a hard place'. Any payment by the debtor to the creditor Martin is contrary to the order of discharge which the debtor received. . . . Yet, if the debtor refuses to pay the discharged debt, he faces the cost and anguish of a criminal trial with the ultimate possibility of a prison sentence. The debtor's anomalous predicament necessitates the issuance of a permanent injunction against the district attorney.⁹³

The bankruptcy court expressed concern that the criminal defendant/debtor, when faced with the legal costs of defending a felony prosecution and the uncertainty of a jury verdict, would, even if innocent, accept a settlement offered by the prosecutor. The court expressly declined to put a debtor in this dilemma.⁹⁴

A comparison of *Wilson* and *Whitaker* indicates that the application of the bad faith—irreparable harm test may lead to inconsistent results. A debtor's injunctive relief may well depend not on the merits of his case but on where the suit is filed.

Applying the Principal Motivation and Bad-Faith Tests Together

Perhaps the best approach when balancing the rights of the debtor and the interests of the state under section 524(a)(2) is reflected in *Redenbaugh v. Gahle (In re Redenbaugh)*.⁹⁵ The court first applied the principal motivation test in determining whether to enjoin the creditor from using criminal prosecution to collect a debt, and then asked whether the state was acting in bad faith in prosecuting.⁹⁶

The debtor in *Redenbaugh* issued two bad checks to the creditor/complaining witness in March 1981. On October 7, 1981, the debtor filed for bankruptcy. Although the creditor received notice of the last day to file objections to the debtor's discharge, he ne-

93. *Whitaker*, 16 Bankr. at 922.

94. *Id.* at 922-23.

95. 37 Bankr. 383 (Bankr. C.D. Ill. 1984).

96. *Id.* at 387.

glected to file an objection. On February 10, 1982, the court discharged the debtor in bankruptcy. In May 1982, the creditor requested that the state file criminal charges against Redenbaugh and the court found probable cause at a preliminary hearing to pursue the prosecution. The debtor sought injunctive relief pursuant to sections 524(a)(2) and 105(a) of the Bankruptcy Code.⁹⁷

The court in *Redenbaugh* decided that the best course to follow was not to enjoin the state criminal action but to prohibit the creditor from receiving any form of restitution ordered by the state court.⁹⁸ Recognizing that the creditor's motivation in pursuing the criminal action was to collect a discharged debt,⁹⁹ the court enjoined the creditor from receiving any portion of his discharged claim because he was "attempting to collect his debt by way of the state court criminal proceedings, when the only place he can have the debt found to be non-dischargeable and therefore collectable, is in the bankruptcy court."¹⁰⁰

The bankruptcy court in *Barnett v. K-Mart*¹⁰¹ went even further. The court in *Barnett* did not look at the creditor's motivation in pursuing the prosecution, but held simply that *any* order to make restitution of a discharged debt would directly conflict with and obstruct the purposes of federal bankruptcy law, and thus would be void under the supremacy clause.¹⁰² Accordingly, a credi-

97. *Id.* at 385.

98. Recognizing the strong policy considerations pitted against each other, the court looked at other decisions concerning whether a discharge in bankruptcy prohibited criminal prosecution. These other courts pursued several different tacks. Some courts recognized that federal courts are hesitant to enjoin a state criminal action but determined that under the circumstances an injunction was warranted. Others recognized that the Bankruptcy Code encourages granting a debtor a "fresh start" but held that the Code did not provide authority to enjoin the state action. A third group recognized the federalism and "fresh start" policies and held that the state criminal action would not be prohibited from accepting any form of restitution from the state court. *Id.* at 386.

99. *Id.* at 387. Judge Lessen stated that the case at bar was similar to *Barnett v. K-Mart* (*In re Barnett*), 15 Bankr. 504 (Bankr. D. Kan. 1981). See *In re Holder*, 26 Bankr. 789 (Bankr. M.D. Tenn. 1982); *Johnson v. Lindsey*, 16 Bankr. 211 (Bankr. M.D. Fla. 1981).

100. *Redenbaugh*, 37 Bankr. at 387 (citing 11 U.S.C. § 523).

101. 15 Bankr. 504 (Bankr. D. Kan. 1981).

102. *Id.* at 510. The court declared:

If a bankruptcy court discharges a debt, the Bankruptcy Code prohibits *any act to collect . . . any such debt*, . . . and thus the civil remedy of restitution, even if arising out of a criminal proceeding, is prohibited. The creditor cannot request restitution or direct the county attorney to request it, and the county

tor arguably is barred per se from receiving any portion of a discharged debt resulting from a criminal prosecution of a debtor.¹⁰³ The state interest in enforcing criminal statutes is protected because the state prosecuting attorney is still free to pursue criminal penalties.

Enjoining Prosecution

The court in *Redenbaugh* declined to enjoin the criminal prosecution because the defendant offered no evidence to indicate that the state prosecutor had acted in bad faith.¹⁰⁴ The court did, however, hold that section 524(a)(2) prohibited the state's attorney from recommending to the state court that the debtor pay restitution as part of a sentence or condition of probation.¹⁰⁵ The court in *Barnett* employed a similar rationale, explicitly relying on the *Younger* doctrine.¹⁰⁶ The court stated that state prosecution would be enjoined when the prosecution was in bad faith, was improvidently brought, or was used to harass the debtor.¹⁰⁷

Given the persistence of the *Younger* abstention doctrine, one might surmise that debtors have a virtually insurmountable burden to show either bad faith by the prosecutor or irreparable injury to themselves. Recent decisions reveal, however, that the bad-faith test is not being applied perfunctorily. Rather, courts are applying the bad-faith test in a fair and equitable manner, protecting the debtor when warranted. The court in *In re Jerzak*¹⁰⁸ recognized that the exercise of its power to enjoin criminal proceedings under section 105(a) was tempered by a recognition of the fact that

attorney cannot recommend it. The federal Bankruptcy Code, by virtue of the Constitution's Supremacy Clause, forbids it, and this Court can and will enjoin any such requests or recommendations.

Id. (emphasis in original).

103. One commentary calls this the most satisfactory approach taken by bankruptcy courts. Kratsch & Young, *supra* note 7, at 119-20. The authors contend that the noninterference and federalism aims of *Younger* as well as the punishment needs of society can be met through this approach. *Id.* at 120.

104. *Redenbaugh*, 37 Bankr. at 387.

105. *Id.*

106. 15 Bankr. at 511.

107. *Id.*

108. 47 Bankr. 771 (Bankr. W.D. Wis. 1985).

every good-faith criminal proceeding should be protected.¹⁰⁹ The court enjoined the state action in *Jerzak* because the state prosecuting authorities had failed to exercise independent judgment in continuing the prosecution.¹¹⁰ A district attorney had requested his counterpart in another county to issue a criminal complaint against the debtor. The court stated, "The conclusion is inescapable that the criminal aspect of Mr. Hogan's prosecution is nothing more than an afterthought of the Lincoln County District Attorney and that the Oneida County criminal proceeding is, but for the caption, a civil action to collect a debt."¹¹¹ The bankruptcy court in *Seidelman v. Texas (In re Seidelman)*,¹¹² after determining that the United States Bankruptcy Code was an expressly authorized exception to the Anti-Injunction Act,¹¹³ enjoined the prosecution on the grounds of bad faith. The court condemned the actions of the bank creditor and stated that the county prosecutor's apparent lack of knowledge of the bank's "machinations" did not immunize it from "the taint of bad faith and illegality."¹¹⁴ The court concluded that state action was invoked improperly to deprive a debtor of his right to a discharge in bankruptcy and that the debtor would suffer irreparable harm if the court did not grant injunctive relief.¹¹⁵

Sometimes a court does not simply accept a self-serving statement by a prosecutor that a case is not being prosecuted to collect a debt,¹¹⁶ but makes an objective determination based on the evi-

109. *Id.* at 773.

110. *Id.* at 773-74. The court relied on the bad-faith test stated in *Davis v. Sheldon*, 691 F.2d 176, 179 (3d. Cir. 1982), that "a criminal proceeding is not brought in good faith when the complaining witness has insufficient evidence to support the allegations, when the prosecuting authority has reason to doubt the validity of the charges, or when the prosecutor fails to exercise independent judgment in continuing the prosecution." *Id.* at 773.

111. *Jerzak*, 47 Bankr. at 774.

112. 57 Bankr. 149 (Bankr. D. Md. 1986).

113. *Id.* at 153 (citing S. REP. No. 989, *supra* note 2, at 29, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 5815). The Anti-Injunction Act states: "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction or to protect or effectuate its judgments." Anti-Injunction Act, 28 U.S.C. § 2283 (1982).

114. *Seidelman*, 57 Bankr. at 155.

115. *Id.*

116. See *supra* notes 59-62 and accompanying text.

dence and testimony presented.¹¹⁷ The use of the bad faith—irreparable injury test to determine whether to enjoin the state's criminal prosecution may be an effective, though imperfect, way to balance the debtor's rights and the state's interests.

Prohibiting Restitution

The courts in *Barnett v. K-Mart*¹¹⁸ and *Redenbaugh v. Gahle*¹¹⁹ suggest that the most satisfying solution to afford a fresh start to the debtor and preserve the state's interest in enforcing criminal statutes is to prohibit the creditor from receiving any restitution imposed as part of a debtor's criminal sentence. The application of section 524(a)(2) thus would not cause any federal interference with state autonomy because the prosecutor could still seek imprisonment or a fine. In *Robinson v. McGuigan*,¹²⁰ the United States Court of Appeals for the Second Circuit invalidated a sentence imposing restitution as a condition of probation. The court in *Robinson* held that criminal restitution was a dischargeable debt under section 523 of the Bankruptcy Code.¹²¹ Other courts have held that the debtor's fresh start is undermined if he is forced to make resti-

117. See, e.g., *Farrell v. Shriver (In re Farrell)*, 43 Bankr. 115 (Bankr. M.D. Tenn. 1984), in which the court declined to enjoin the state criminal prosecution. In *Farrell*, two arrest warrants for the debtor were issued 11 days before the debtor filed for bankruptcy. The debtor testified that neither the district attorney nor the creditor had offered to drop the charges against him in exchange for restitution. The prosecutor testified that dismissal of the charges would have been inappropriate due to the debtor's prior record, which included two felony convictions. *Id.* at 116. The court stated:

The fresh start which Congress has provided under the Bankruptcy Act means a financial fresh start and not a freedom to violate the criminal laws of the State of Tennessee, seek a discharge in bankruptcy and cry immunity. . . . The public has an interest in every good faith criminal prosecution. . . . This interest is of such a magnitude that it overrides the possibility that a bankruptcy court can act as a haven for criminals.

Id. at 117.

118. 15 Bankr. 504 (Bankr. D. Kan. 1981).

119. 37 Bankr. 383 (Bankr. C.D. Ill. 1984).

120. 776 F.2d 30 (2d. Cir 1985). For a discussion of the mixed case law concerning whether criminal restitution is a debt, and therefore dischargeable in bankruptcy, see Note, *In re Robinson: A Haven for Criminal Offenders*, 37 MERCER L. REV. 1625 (1986).

121. *Robinson*, 776 F.2d at 40.

tution.¹²² Not all courts hesitate to impose restitution as a proper remedy. The United States Courts of Appeals for the Fifth and Eleventh Circuits have upheld sentences of restitution.¹²³ In *Padgett v. Latham*,¹²⁴ a case in which the debtor sought injunctive relief from criminal prosecution under section 524(a)(2), the bankruptcy court refused to enjoin the state court from imposing criminal restitution.¹²⁵ The court in *Padgett* stated that a state court's order of restitution was not synonymous with debt collection activities and that "any sanction deemed appropriate by the state court in such criminal proceedings does not contravene bankruptcy policy."¹²⁶

Courts must consider the practical effect of a per se rule prohibiting restitution to creditors. First, a court's choice of remedies is narrowed automatically. Second, a debtor may prefer restitution to a fine or imprisonment. Moreover, although the bankruptcy courts do not have the power to enjoin other courts,¹²⁷ enjoining the creditor/complaining witness may effectively end the prosecution. If the sole incentive of the creditor in pursuing the criminal proceeding is to collect the discharged debt, he may lose interest in pursuing the charge absent the chance of personal financial gain. Without the creditor, the prosecution loses its chief witness.¹²⁸ The

122. See *Holder v. Dotson* (*In re Holder*), 26 Bankr. 789, 791-92 (Bankr. M.D. Tenn. 1982); *Lawson v. Boczonadi* (*In re Lawson*), 22 Bankr. 100, 104 (Bankr. S.D. Ohio 1982); *Johnson v. Lindsey*, 16 Bankr. 211, 213 (Bankr. M.D. Fla. 1981).

123. *United States v. Carson*, 669 F.2d 216 (5th Cir. 1982); *Barnett v. Evans*, 673 F.2d 1250 (11th Cir. 1982).

124. 37 Bankr. 280 (Bankr. W.D. Ky. 1983).

125. *Id.* at 285.

126. *Id.* One commentator has argued that because restitution focuses on punishing and rehabilitating the offender, rather than on compensating the victim, no conflict need exist between a state order of restitution and a federal discharge in bankruptcy. Mehler, *supra* note 59, at 834. This observation seems questionable because restitution is defined as "the act of making good or giving equivalent for any loss, damage, or injury," BLACK'S LAW DICTIONARY 1180 (5th ed. 1979), and "the restoration to a person of that of which he has been wrongly deprived." BALLENTINE'S LAW DICTIONARY 1107 (3d ed. 1969). Restitution thus focuses on compensating the victim, not on punishing the offender.

127. "[A] bankruptcy court shall have the powers of a court of equity, law, and admiralty, but may not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment." 28 U.S.C. § 1481 (1982).

128. See *Hendel & Reinhardt*, *supra* note 5, at 239 (in bad check cases, the complaining witness or his agents generally are the only ones who can authenticate the debtor's signature on the check).

bankruptcy courts were not designed to shield a debtor from criminal prosecution.¹²⁹ As one commentator notes, the courts must consider carefully whether "excising the restitution feature of the criminal sentence [will] cause the charges to be dropped and allow the guilty to go free."¹³⁰

Imposing Fines Instead of Restitution

At least one court has advocated that the imposition of fines instead of restitution is the better remedy.¹³¹ Three primary reasons support this view. First, fines imposed in criminal proceedings and payable to and for the benefit of a government unit are nondischargeable.¹³² Thus, imposition of a fine avoids the potential, subsequent problem of determining whether criminal restitution is dischargeable or nondischargeable. Second, imposition of a fine rather than restitution prevents creditors from using the state criminal courts as a public debt collection system.¹³³ The court in *Holder v. Dotson* stated that "criminal statutes should be designed to redress public, not private, wrongs."¹³⁴ Finally, proponents of fines argue that restitution contravenes the rehabilitative purpose of bankruptcy.¹³⁵ In fact, one court has ruled that a state bad check statute requiring restitution was unconstitutional.¹³⁶

129. See *supra* notes 1-2 and accompanying text.

130. Rendelman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 740 (1980).

131. See *Holder v. Dotson* (*In re Holder*), 26 Bankr. 789 (Bankr. M.D. Tenn. 1982).

132.

A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt— . . . to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss. . . .

11 U.S.C.A. § 523(a)(7) (West Supp. 1987). See *City of Memphis v. Wilson*, 31 Bankr. 191 (Bankr. W.D. Tenn. 1984) (applying § 423(a)(7)).

133. *Holder*, 26 Bankr. at 793.

134. *Id.*

135. *Id.* at 792.

136. *In re Manier*, Bankr. L. Rep. (CCH) ¶ 68,670 (Bankr. M.D. Tenn. 1980). The bankruptcy court in *In re Manier* stated that requiring a state judge to impose restitution thwarted the rehabilitative purpose of federal law in violation of the supremacy clause. Bankruptcy Judge Jennings stated that the court's declaration did not prohibit criminal prosecution, but prohibited only the penalty imposed on the criminal debtor. *Id.* ¶ 80,717 & n.4.

Imposition of a fine, however, still saddles the bankrupt debtor with a financial burden resulting from a criminal proceeding, and this can impair his fresh start after bankruptcy. If a debtor must pay, the unsatisfied creditor, rather than the state, seems the more worthy recipient.

Using the Nondischargeability Provisions

Section 524 of the Bankruptcy Code concerns the effect of a discharge in bankruptcy. Several courts have suggested that rather than trying to evade the effect of 524(a)(2) on discharged debts, creditors should focus their efforts on having certain debts declared nondischargeable under section 523 of the Bankruptcy Code.¹³⁷ One commentator has urged courts to "integrate the use of their injunctive relief powers with the nondischargeability provisions of section 523."¹³⁸ The court in *Barnett v. K-Mart*¹³⁹ stated that litigating the issue of dischargeability under section 523 of the Code allows a creditor to protect himself "without running roughshod over immunities that the United States, acting through a specifically granted, exclusive power has chosen to give its citizens."¹⁴⁰ The conflict between federal and state law also is resolved. If a debt is nondischargeable, the state prosecution may proceed without undermining provisions and policies of federal law. Section 523 excepts nine categories of debt from discharge in bankruptcy.¹⁴¹ Nondischargeable debts include certain taxes and customs,¹⁴² money, goods, or credit falsely or fraudulently obtained,¹⁴³ unscheduled debts,¹⁴⁴ debts incurred while acting in a fiduciary capacity or for defalcation, embezzlement, or misappropriation,¹⁴⁵ debts for willful and malicious conversion or injury by the

137. *E.g.*, *Barnett v. K-Mart (In re Barnett)*, 15 Bankr. 504 (Bankr. D. Kan. 1981); *Anson v. Hopkins*, 9 Bankr. 741 (Bankr. W.D. Mo. 1981); *Barth v. Broshot (In re Broshot)*, 4 Bankr. 151 (Bankr. W.D. Mo. 1980).

138. *See Mehler, supra* note 59, at 835-37.

139. 15 Bankr. 504.

140. *Id.* at 511 (quoting *Kesler v. Dep't of Pub. Safety*, 369 U.S. 153, 184 (1961) (Black, J. and Douglas, J., dissenting)).

141. 11 U.S.C. § 523(a) (1982), *amended by* 11 U.S.C.A. § 523(a) (West Supp. 1987).

142. *Id.* § 523(a)(1).

143. *Id.* § 523(a)(2).

144. *Id.* § 523(a)(3).

145. *Id.* § 523(a)(4).

debtor,¹⁴⁶ alimony or child support,¹⁴⁷ fines and penalties payable to the government,¹⁴⁸ most government-backed student loans,¹⁴⁹ and debts found nondischargeable in a previous bankruptcy case.¹⁵⁰ The nondischargeability of certain categories of debts serves the congressional intent that only the *honest* debtor be given a fresh start in bankruptcy.¹⁵¹

If creditors actively participate in the bankruptcy process, courts avoid the conflict between federal policy and state interest caused by a discharge under 524(a)(2). Subsection (c) of section 523 requires a creditor who is owed a debt that may be excepted from discharge under subsections (a)(2), (a)(4), or (a)(6) to initiate proceedings in bankruptcy court.¹⁵² If the creditor does not act, the debt is discharged.¹⁵³ Furthermore, these exceptions are construed narrowly against the creditor¹⁵⁴ and are confined to those plainly

146. *Id.* § 523(a)(6).

147. *Id.* § 523(a)(5).

148. *Id.* § 523(a)(7).

149. *Id.* § 523(a)(8).

150. *Id.* § 523(a)(9).

151. *In re Oxford Investment Co.*, 246 F. Supp. 651, 653 (S.D. Cal. 1965); *see also* Inahara v. Harris (*In re Harris*), 458 F. Supp. 238 (D. Or. 1976) (purpose of Bankruptcy Act to discharge honest debts of honest debtors), *aff'd*, 587 F.2d 451 (9th Cir. 1978), *cert. denied*, 442 U.S. 918 (1979). For a discussion of the various nondischargeability provisions, *see* Berger, *Tax or Penalty? Dischargeable in Bankruptcy?* 83 COM. L.J. 79 (1978); Hinderks, *Preserving Tort Claims Against a Debtor in Bankruptcy; Tort-Based Exceptions to Discharge*, 53 KAN. B.A.J. 31 (1984); Hoffman & Murray, *Obligations that Cannot Be Erased*, 5 FAM. ADVOC. 18 (Winter 1983); Kalevitch, *Educational Loans in Bankruptcy*, 2 N. ILL. U.L. REV. 325 (1982); Kosel, *Running the Gauntlet of "Undue Hardship"-The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE U.L. REV. 457 (1981); Swann, *Dischargeability of Domestic Obligations in Bankruptcy*, 43 TENN. L. REV. 231 (1976); Zaretsky, *The Fraud Exception to Discharge Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 253 (1979).

152.

Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owned, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as this case may be, of subsection (a) of this section.

11 U.S.C. § 523(c).

153. S. REP. NO. 989, *supra* note 2, at 1, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 5787.

154. *See* Houtman v. Mann (*In re Houtman*), 568 F.2d 651 (9th Cir. 1978); Shepherd v. McDonald, 157 F.2d 467 (9th Cir. 1946), *cert. denied*, 329 U.S. 802 (1947); Quadra, Ltd. v. Konchan (*In re Konchan*), 36 Bankr. 393 (Bankr. N.D. Ill. 1984); Finance One, Inc. v. Scarbaci (*In re Scarbaci*), 34 Bankr. 344 (Bankr. S.D. Fla. 1983); French v. United States, 20

expressed¹⁵⁵ because the purpose of bankruptcy is to provide financial relief to the debtor.

For a creditor to use the nondischargeability provisions of section 523, the debt must fit one of the specific nondischargeable provisions. In many of the 524(a)(2) discharge cases, the creditor tries to collect on bad checks.¹⁵⁶ A diligent creditor seeking to have the bad check debt declared nondischargeable would rely on section 523(a)(2)(A), the fraud provision. Courts are split on whether delivery of a check returned for insufficient funds is, by itself, sufficient to sustain a determination of nondischargeability under section 523(a)(2).

The majority of courts, relying on article 3 of the Uniform Commercial Code¹⁵⁷ and the Supreme Court's decision in *Williams v. United States*,¹⁵⁸ have held that a bank check is not a financial statement or a representation as to whether the check will be honored upon presentment.¹⁵⁹ A number of courts, however, have held that the tender of a check is an implied representation by the

Bankr. 155 (Bankr. D. Or. 1982); *Sanitation Recycling, Inc. v. Jay Peak Lodging Ass'n, Inc.*, 428 F. Supp. 1022 (D. Vt. 1977).

155. See *Gleason v. Thow*, 236 U.S. 558 (1915).

156. E.g. *Redenbaugh v. Gahle (In re Redenbaugh)*, 37 Bankr. 383 (Bankr. C.D. Ill 1984); *Padgett v. Latham (In re Padgett)*, 37 Bankr. 280 (Bankr. W.D. Ky. 1983); *In re Goodman*, 34 Bankr. 34 (Bankr. D. Or. 1983).

157. Relevant provisions of the U.C.C. include §§ 3-409(1), 3-412(1), 3-104(2)(b), and 3-104(1)(b). One court has stated that "article 3 imposes no warranty that the drawer's account contains sufficient funds to pay the check upon presentment." *Western Petroleum v. Burgstaler (In re Burgstaler)*, 58 Bankr. 508, 513 (Bankr. D. Minn. 1986).

158. 458 U.S. 279 (1982). Justice Blackmun noted in his majority opinion that "a check is not a factual assertion at all, and therefore cannot be characterized as 'true' or 'false'. . . . Each check did not . . . make any representation as to the state of petitioner's bank balance." *Id.* at 284-85.

159. E.g., *Newberry Feed and Farm Center v. Miller (In re Miller)*, 57 Bankr. 52 (Bankr. D.S.C. 1985); *WSE Warehouse v. Holmes (In re Holmes)*, 52 Bankr. 35 (Bankr. W.D. Pa. 1985); *Timberline Sys. Inc. v. Hammet (In re Hammet)*, 49 Bankr. 533 (Bankr. M.D. Fla. 1985); *Energy Marketing Co. v. Sutton (In re Sutton)*, 39 Bankr. 390 (Bankr. M.D. Tenn. 1984); *Merrill Lynch, Pierce, Fenner & Smith v. Younesi (In re Younesi)*, 34 Bankr. 828 (Bankr. C.D. Ca. 1983); *Heinold Commodities & Securities v. Hunt (In re Hunt)*, 30 Bankr. 425 (M.D. Tenn. 1983); *American Bank & Trust v. Lamb (In re Lamb)*, 28 Bankr. 462 (Bankr. W.D. La. 1983); *A.G. Edwards & Sons v. Paulk (In re Paulk)*, 25 Bankr. 913 (Bankr. M.D. Ga. 1982); *Hill v. Murray (In re Murray)*, 7 Bankr. 899 (Bankr. W.D. Mo. 1981); *Save-On Oil Co. v. Wise (In re Wise)*, 6 Bankr. 867 (Bankr. M.D. Fla. 1980).

maker that funds are available to honor the check when presented.¹⁶⁰

The majority position, holding that bad check debts are not per se nondischargeable, seems the better view. The Supreme Court in *Neal v. Clark*¹⁶¹ held that fraud in the bankruptcy discharge provisions meant "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, . . . and not implied fraud . . . which may exist without the imputation of bad faith or immorality. . . . A different construction would be inconsistent with the liberal spirit which pervades the entire bankruptcy system."¹⁶² Declaring bad check debts to be fraud per se and therefore not dischargeable is inconsistent with a narrow interpretation of section 523(a) and with the rehabilitative intent of the discharge effect of section 524. According to the majority view, a debt is nondischargeable under section 523(a)(2)(A) if a creditor shows that at the time value was obtained, four conditions existed. First, the debtor employed means to obtain value which he knew were false or which were in reckless disregard of truth. Second, representation was made to deceive or otherwise wrongfully induce the creditor. Third, the creditor actually and reasonably relied on such representation, and fourth, damage was sustained as result of representation.¹⁶³ Because most courts require a creditor to prove these elements in all fraud cases,¹⁶⁴ often by clear and convincing evidence,¹⁶⁵ and because the nondischargeability provisions are construed strictly,¹⁶⁶

160. *E.g.*, *Frits Loonsten, Inc. v. Mullin* (*In re Mullin*), 51 Bankr. 377 (Bankr. S.D. Ind. 1985); *Bear Stearns & Co. v. Kurdoghlian* (*In re Kurdoghlian*), 30 Bankr. 500 (Bankr. 9th Cir. 1985); *Tate v. Tabers* (*In re Tabers*), 28 Bankr. 679 (Bankr. W.D. Ky. 1983); *Monarch Tile Mfg. v. Anderson* (*In re Anderson*), 10 Bankr. 296 (Bankr. W.D. Wis. 1981).

161. 95 U.S. 704 (1877).

162. *Id.* at 709.

163. *See De Bartolo v. Kyriazes* (*In re Kyriazes*), 38 Bankr. 353, 354 (Bankr. N.D. Ill. 1983); *Marine Midland Bank v. Drayer* (*In re Drayer*), 29 Bankr. 831-833 (Bankr. D. Mass. 1983); *Cuneo v. Smith* (*In re Smith*), 25 Bankr. 396, 398 (Bankr. D. Md. 1982); *Revelle Motors, Inc. v. Spector* (*In re Spector*), 22 Bankr. 226, 232 (Bankr. N.D.N.Y. 1982).

164. *See, e.g.*, *Salecki v. Commonwealth* (*In re Salecki*), 51 Bankr. 364 (Bankr. E.D. Va. 1985).

165. *See, e.g.*, *Beneficial Finance Co. v. Jackson* (*In re Jackson*), 32 Bankr. 549 (Bankr. E.D. Va. 1983); *Groat v. Toleikis* (*In re Toleikis*), 19 Bankr. 944 (Bankr. E.D. Mich. 1982); *Thorp Credit and Thrift Co. v. Pommerer* (*In re Pommerer*), 10 Bankr. 935 (Bankr. D. Minn. 1981).

166. *See supra* text accompanying notes 147-48.

the practical effect of using section 523(a)(3)(A) to avoid the injunctive bar on collection efforts under section 524(a)(2) is limited.

Even diligent creditors who file a timely objection to a debtor's discharge in accordance with section 523(c) often fail to avoid the sweeping effects of bankruptcy's discharge. The creditors in *Wilson v. Estes*,¹⁶⁷ for example, sought to exclude their claim from discharge, contending that because the debtor had defrauded them while acting in a fiduciary capacity, the obligation was nondischargeable.¹⁶⁸ However, the court determined that the relationship between the parties was not within the nature of a trust necessary to establish a fiduciary relationship and discharged the debtor.¹⁶⁹ The original creditor in *Kaping v. Oregon*¹⁷⁰ also failed to have its claim for child support declared nondischargeable. The nondischargeability provisions therefore allow courts to escape the federal-state conflict created by criminal prosecution of a bankrupt debtor in only a limited number of situations.

CONCLUSION: SUGGESTING A BALANCING APPROACH

The bankruptcy courts essentially are courts of equity,¹⁷¹ applying principles and rules of equity jurisprudence.¹⁷² The Supreme Court in *Pepper v. Litton*¹⁷³ stated that these equitable principles "have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done."¹⁷⁴ In short, the bankruptcy court must make decisions according to the equities of the case. Bankruptcy courts should approach with caution any test or sweeping rule that would inhibit a court's broad powers to render fair and equitable decisions and remedies. The shortcomings of a blanket prohibition on imposing criminal restitution and

167. 30 Bankr. 91 (Bankr. E.D. Tenn. 1983).

168. *Id.* at 93-94.

169. *Id.* at 94 n.5.

170. 13 Bankr. 621 (Bankr. D. Or. 1981).

171. *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934).

172. *Larson v. First State Bank*, 21 F.2d 936, 938 (8th Cir. 1927).

173. 308 U.S. 295 (1939).

174. *Id.* at 305. In *Bank of Marin v. England*, 385 U.S. 99 (1966), the Supreme Court stated, "There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Id.* at 103.

the limited applicability of using the nondischargeability provisions have been discussed previously.¹⁷⁵

Federal courts repeatedly have relied on the primary motivation of the prosecution test or the bad faith—irreparable harm test to address this federal-state conflict. The basic question all courts have tried to answer is whether the criminal prosecution of the discharged debtor is intended to promote the valid state interest of enforcing criminal statutes or whether it is simply a debt collection device. In order to answer this question properly, a court should carefully examine the actions of the parties and the surrounding circumstances in each case. Factors a court should consider include whether the criminal proceedings were initiated before the debtor filed bankruptcy, whether the state offered to drop the charges if restitution to the creditor was made, whether the state maintained an active interest in aggressively prosecuting the case, and whether the prosecutor exercised independent judgment in pursuing the case. Exercising independent judgment would include investigating the validity of the charges, ascertaining whether any evidence supported the allegations, and, if possible, attempting to determine the complaining witness's motivation in bringing the charges. After examining these factors and carefully balancing the equities of the case, a bankruptcy court must attempt to effectuate twin congressional intents of affording a debtor a fresh financial start and not allowing debtors to use bankruptcy as a haven from state criminal action.

In other contexts, a case-by-case balancing approach might cause greater uncertainty and delay in court proceedings.¹⁷⁶ Making an equitable decision after evaluating relevant factors in a section 524(a)(2) case, however, should not cause any more uneven justice than has resulted from courts relying on subjective testimony or

175. See *supra* text accompanying notes 118-22, 156-63.

176. Professor Redish has suggested a balancing approach to solve a federal-state conflict in a nonbankruptcy context. In *The Doctrine of Younger v. Harris: Deference in Search of a Rationale*, 63 CORNELL L. REV. 463, 485-87 (1978), Redish suggests that "federal courts should balance, on a case-by-case basis, the danger of disruption to state proceedings against the strength of the individual's need for immediate review by a federal tribunal." Federal review is appropriate in three types of cases: first amendment issues, issues unlikely to arise often in a state criminal proceeding and therefore unlikely to impinge greatly on the state judicial process, and important or recurring issues that cannot be reviewed by a petition for habeas corpus.

interpreting what constitutes bad faith. Creditors and debtors will know the relevant criteria of a court's decisionmaking process. Creditors must realize that a criminal prosecution can be pursued only if it is free of the taint of debt collection. Debtors must be aware that filing for bankruptcy will not prevent a valid state prosecution. Most important, this flexible approach of examining largely objective factors allows a federal court to protect both federal and state rights and policies as the equities of the case demand. No court has held that section 524(a)(2) automatically bars criminal prosecution of the debtor. This provision, however, should prevent creditors from using state criminal actions to collect debts properly discharged in federal bankruptcy court. Courts must investigate the circumstances of each case to ensure that unscrupulous creditors and dishonest debtors do not abuse the bankruptcy system.

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