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*by*
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The bankruptcy laws are not a haven for criminal offenders . . . .[1]

## I. Introduction

Criminal restitution, as an obligation to pay money, looks like a debt. Yet the non-dischargeability of criminal restitutive obligations in bankruptcy presents a conflict between the principles of bankruptcy law—to give "honest" debtors a "fresh start" by discharging their debts—and the criminal justice system's goals of punishment and rehabilitation.[2] Restitution, with civil origins in contract law, is now commonly used in criminal law as a form of punishment for non-violent crimes.[3] While contract restitution attempts to make the plaintiff whole

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1. H.R. REP. No. 595, 95th Cong., 1st Sess. 342-43 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299; S. REP. No. 989, 95th Cong., 2d Sess. 51-52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5837. Justice Blackmun has noted that "there is no suggestion in the Bankruptcy Code that it may used as a shield to protect a criminal from punishment for his crime." Pennsylvania Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 564 (1990) (Blackmun, J., dissenting).

2. In *Local Loan Co. v. Hunt,* the Supreme Court recognized that

> [o]ne of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." . . . [The Bankruptcy Act] gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.

292 U.S. 234, 244 (1934) (quoting Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554-55 (1915)).

In *Kelly v. Robinson,* the Court noted "the difficulties the courts will have in coordinating the Bankruptcy Code with state criminal restitution statutes." 479 U.S. 36, 59 n.6 (1986).

3. Bruce R. Jacob, *Reparation or Restitution by the Criminal Offender to His Victim: Applicability of an Ancient Concept in the Modern Correctional Process,* 61 J. CRIM. L., CRIMINOLOGY & POLICE SCI. 152, 155-56 (1970) ("Reparation by the offender to the victim is required by criminal courts today chiefly in cases involving property crimes and principally in

by returning her to the position she occupied prior to the defendant's breach,[4] criminal restitution not only attempts to make the victim whole, but also seeks to punish the defendant. Criminal restitution thus adds to the civil overtones of victim compensation the further explicit goals of rehabilitation and punishment.[5] Restitution has proved to be an effective penal sanction: it vindicates the public's desire to obtain justice,[6] reduces crowding in prisons by allowing petty criminals to maintain their liberty,[7] and furthers rehabilitative aims by making the criminal "pay" for her crime.[8]

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connection with the use of the suspended sentence or probation."). Jacob notes a more practical reason as well: "[S]ince perpetrators of violent crimes are typically poor or financially destitute, a judgment against such offenders would be uncollectible." *Id.* at 152 (footnote omitted). *See also* Note, *Victim Restitution in the Criminal Process: A Procedural Analysis*, 97 HARV. L. REV. 931, 933 (1984) ("[Restitution] is not an appropriate punishment for all crimes. . . . [R]estitution alone is unlikely to be a sufficiently severe sanction for cases involving wealthy defendants or violent crimes, although it can still be effectively utilized in such cases if combined with other criminal penalties.") (footnote omitted).

4. E. ALLAN FARNSWORTH, CONTRACTS § 12.19, at 946-47 (2d ed. 1990). Restitution as a remedy for breach of contract requires that the breaching party "account for a benefit that has been conferred by the injured party." *Id.* at 946. Restitution as a contract remedy seeks not to enforce the promise, but to prevent unjust enrichment. *Id.* at 947.

5. Criminal restitution as recompense to the victim is similar to contract restitution. Under an economic analysis, contract law imposes no stigma on the breacher because of the notion of "efficient breach." "Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses." Patton v. Mid-Continent Sys., 841 F.2d 742, 750 (7th Cir. 1988) (Posner, J.). Punitive damages are inappropriate for breach of contract because "they will encourage performance when breach would be socially more desirable." FARNSWORTH, *supra* note 4, at 848; *see also* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 105-14 (3d ed. 1986) (compelling performance wastes resources; remedy should be limited to simple damages). However, criminal restitution goes beyond recompense. Because of the stigma attached to a criminal proceeding, and the fact that restitution may be tied to a suspended sentence or probation, "a criminal conviction, unlike [a] civil judgment, carries with it the stigma, or brand, of societal condemnation." Mary M. Cheh, *Constitutional Limits on Using Civil Remedies to Achieve Criminal Law Objectives: Understanding and Transcending the Criminal-Civil Law Distinction*, 42 HASTINGS L.J. 1325, 1352 (1991). However, this is only one distinction between contract and criminal restitution; and the line between civil and criminal sanctions is unclear at best and subject to some debate. *Id.* at 1350-69. Criminal restitution clearly serves purposes beyond that contemplated by contract law, since often restitution can exceed the victim's loss and serves as a condition to probation. *See infra* Part III.

6. This serves an underlying purpose of preventing private retribution. Restitution " 'is emotionally felt as "compensation" for the public damage done.' " Note, *supra* note 3, at 936 (quoting Jerome Hall, *Interrelations of Criminal Law and Torts* (pt.2), 43 COLUM. L. REV. 967, 971 (1943)).

7. Note, *supra* note 3, at 931-32.

8. Restitution allows the "offender . . . [to] express guilt in a socially acceptable manner and . . . increase his self-respect by gaining a sense of accomplishment." By requiring the offender to pay the victim directly, rather than requiring the offender to pay "the abstract, impersonal state," restitution "impresses upon the offender his responsibility to others." This furthers rehabilitation more effectively than fines. Note, *supra* note 3, at 938.

The bankruptcy discharge exonerates the debtor of her future liability to pay existing claims.[9] This economic rehabilitation is designed to promote the credit economy prevalent in the United States.[10] In the case of criminal restitution obligations, however, this goal of economic rehabilitation comes into conflict with the goals of criminal rehabilitation and punishment.

Bankruptcy courts and eventually the United States Supreme Court wrestled with the problem of debtors who sought to discharge in bankruptcy a criminal restitutive obligation that was a condition of probation.[11] Bankruptcy courts either discharged restitutive obligations by emphasizing their contract origins[12] or found them non-dischargeable by emphasizing restitution's punitive nature as criminal punishment, and cited federalism concerns about bankruptcy court interference with state court criminal judgments.[13] In 1986, the Supreme Court directly con-

9. The bankruptcy discharge is codified in 11 U.S.C. § 727 for Chapter 7 proceedings, 11 U.S.C. § 727 (1988), and § 1328 for Chapter 13 proceedings, 11 U.S.C. § 1328 (1988 & Supp. II 1990). Chapter 7 proceedings are "liquidations" in which the debtor's non-exempt assets are liquidated by the trustee to pay creditors. Chapter 13 debtors repay some or all of their creditors through a repayment plan administered by a trustee. *See infra* Part II.C.2. The discharge granted in Chapter 7 and Chapter 13 cases relieves the debtor from prior financial liabilities and enjoins creditors from making further collection efforts. *See* 11 U.S.C. § 524 (1988). By wiping the financial slate clean, the debtor obtains a "fresh start." The discharge granted in Chapters 7 and 13 is discussed more fully *infra* in Part II.C.

10. "The primary function of the bankruptcy system is to continue the law-based orderliness of the open credit economy in the event of a debtor's inability or unwillingness generally to pay his debts . . . [by] rehabilitat[ing] debtors for continued and more value-productive participation, *i.e.*, to provide a meaningful 'fresh start.'" REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 1, at 71 (1973) [hereinafter COMMISSION REPORT].

11. *Compare* Kelly v. Robinson, 479 U.S. 36 (1986) (criminal restitutive obligation non-dischargeable in Chapter 7 case) *with* Pennsylvania Dep't of Pub. Welfare v. Davenport, 495 U.S. 552 (1990) (criminal restitutive obligation dischargeable in Chapter 13 proceeding).

12. *See, e.g., Davenport,* 495 U.S. at 564 (criminal restitutive obligations are "debts" as defined by Bankruptcy Code and therefore dischargeable); Multnomah County v. Price (*In re* Price), 920 F.2d 562, 562 (9th Cir. 1990) (discharging restitutive obligation in Chapter 13 case, following holding of *Davenport* without discussion); Cullens v. District Court (*In re* Cullens), 77 B.R. 825, 828 (Bankr. D. Colo. 1987) (restitutive obligations dischargeable in Chapter 13 case because § 523(a)(7), which was applicable only to Chapter 7 cases, indicated congressional intent to confine non-dischargeability of restitutive obligations to Chapter 7 cases); *In re* Vohs, 58 B.R. 323, 326 (Bankr. D. Mont. 1986) (restitutive obligations dischargeable in Chapter 13 case where state's main goal in imposing restitution is to compensate victim).

13. *See, e.g., Kelly,* 479 U.S. at 53 (criminal restitutive obligation non-dischargeable because it fit within § 523(a)(7) exception to discharge for criminal fines, penalties and forfeitures); United States v. O'Connell (*In re* O'Connell), 80 B.R. 475, 476 (Bankr. E.D. Mo. 1987) (restitution imposed to further penal and rehabilitative goals, not as compensation to victim; therefore, not a debt dischargeable in Chapter 7 proceeding); Pennsylvania Dep't of Pub. Welfare v. Oslager (*In re* Oslager), 46 B.R. 58, 61-62 (Bankr. M.D. Pa. 1985) (court looked to state law to determine intent of restitution and determined restitution was not dischargeable in Chapter 7 proceeding based on federalism concerns and court's finding that restitution was not a debtor/creditor relationship rooted in contract law, but a criminal sanction); Black Hawk

fronted the issue in *Kelly v. Robinson*,[14] a Chapter 7 liquidation case, and found that criminal restitution could not properly be discharged in bankruptcy because restitution fit within the discharge exceptions for criminal fines, penalties, and forfeitures.[15] However, the *Kelly* Court declined to decide whether restitution was a "debt" within the meaning of the Bankruptcy Code,[16] and cited federalism as a further basis for its decision.[17] Four years later the Court addressed the restitution dischargeability problem in a Chapter 13 case. In *Pennsylvania Department of Public Welfare v. Davenport*,[18] the Court distinguished *Kelly* and discharged the debtor's restitutive obligations,[19] finding that restitution was a debt under the Bankruptcy Code. The Court's decision was further supported by the discharge provisions of Chapter 13, which are more generous than

County v. Vik (*In re* Vik), 45 B.R. 64, 67, 69 (Bankr. N.D. Iowa 1984) (nature of restitution such that its central focus is not payment to victim; therefore, not a debt dischargeable in Chapter 7 proceeding); Pellegrino v. Division of Crim. Justice (*In re* Pellegrino), 42 B.R. 129, 134 (Bankr. D. Conn. 1984) (although "debt" as defined in Bankruptcy Code does not explicitly include restitution, federalism and congressional policy require non-dischargeability in Chapter 7 case); *In re* Button, 8 B.R. 692, 694 (Bankr. W.D.N.Y. 1981) (restitution imposed as criminal punishment not dischargeable in Chapter 7 proceeding); *see also* Federal Deposit Ins. Corp. v. Wright (*In re* Wright), 87 B.R. 1011, 1016 (Bankr. D.S.D. 1988) (*Kelly* applies to restitution imposed under federal law).

14. 479 U.S. 36 (1986). See *infra* Part V for a detailed discussion of the facts and issues in the *Kelly* case.

15. 479 U.S. at 50. Section 523(a)(7) of the Bankruptcy Code excepts from discharge in a Chapter 7 proceeding "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit [that] is not compensation for actual pecuniary loss." 11 U.S.C. § 523(a)(7) (1988).

16. 479 U.S. at 50. "[W]e need not address [the] question . . . [of whether restitution is a debt] because we hold that § 523(a)(7) preserves from discharge any condition a state criminal court imposes as part of a criminal sentence." *Id.*

17. The Court stated:

> Our interpretation of the [Bankruptcy] Code also must reflect . . . a deep conviction that federal bankruptcy courts should not invalidate the results of state criminal proceedings. The right to formulate and enforce penal sanctions is an important aspect of the sovereignty retained by the States. This Court has emphasized repeatedly "the fundamental policy against federal interference with state criminal prosecutions."

*Id.* at 47 (quoting Younger v. Harris, 401 U.S. 37, 46 (1971)).

18. 495 U.S. 552 (1990).

19. *Id.* at 564. The Court noted that "it would be anomalous to construe 'debt' narrowly so as to exclude criminal restitution orders." *Id.* at 562. Following an expansive construction of debt, and the broad discharge provisions of Chapter 13, the Court concluded that " '[i]t is preferable for debtors to attempt to pay such debts to the best of their abilities over three years' " in a Chapter 13 plan. *Id.* at 563 (quoting 5 COLLIER ON BANKRUPTCY ¶ 1328.01[1][c] (Lawrence P. King ed., 15th ed. 1986)). "[T]o construe 'debt' narrowly in this context [Chapter 13] would be to override the balance Congress struck in crafting the appropriate discharge exceptions for Chapter 7 and Chapter 13 debtors." *Id.* The Court found it logical that Congress could have concluded "a debtor's interest in full and complete release of his obligations outweighs society's interest in collecting or enforcing a restitution obligation outside the agreement reached in the Chapter 13 plan." *Id.* at 561.

those governing Chapter 7.[20] Congress immediately responded to the *Davenport* decision by amending Bankruptcy Code § 1328, which governs Chapter 13 discharges, to specifically state that criminal restitutive obligations are non-dischargeable in a Chapter 13 proceeding.[21]

Is Congress' solution the best or only response to the criminal restitution dischargeability problem? This Note examines the policies promoted by bankruptcy discharge and criminal restitution. There is both conflict and harmony inherent in the policies underlying the imposition of restitution as a criminal punishment and the goals behind bankruptcy discharge. Federalism and preemption issues also arise when restitution and discharge confront one another in bankruptcy court.[22] A survey of these policies and issues will demonstrate that the *Davenport* case was correctly decided: criminal restitution should be considered a debt. An examination of the discharge exceptions of the Bankruptcy Code, however, reveals some instances of a "conditional" type of discharge—one which is based on the debtor's ability to pay. These more flexible discharge provisions suggest that an equitable alternative to Congress' rigid approach to the problem is available. Using these "conditional" discharge provisions as examples, this Note proposes a solution in accord with the broadly read discharge of *Davenport*—a solution which satisfies both the concern that discharge abrogates the effectiveness of restitution as a punishment and violates the doctrine of federal non-interference with state criminal prosecutions, as well as the concern that the goals of bankruptcy be fulfilled.

Bankruptcy discharge and criminal restitution share common goals, and are more allies than rivals. Rehabilitation is sought by both bankruptcy law, through the discharge of debts,[23] and by criminal law,

20. *See infra* Part II.C.2.

21. *See* Crime Control Act of 1990, Pub. L. No. 101-647, § 3103, 104 Stat. 4789, 4916. The Act amended § 1328(a) of the Bankruptcy Code by adding subsection (3) to explicitly except criminal restitutive obligations from discharge under Chapter 13. *Id.* The Criminal Victims Protection Act of 1990, Pub. L. No. 101-581, § 3, 104 Stat. 2865, 2865, also amended § 1328(a) in an identical manner. Section 1328(a) now reads, in part:

> (a) As soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . . , except any debt—
>
> . . .
>
> (3) for restitution included in a sentence on the debtor's conviction of a crime.

The earlier of these amendments was enacted on November 15, 1990, and became effective immediately. Pub. L. No. 101-581, § 4, 104 Stat. at 2865.

22. Both *Kelly* and *Davenport* specifically addressed the federalism problem, and *Kelly*'s finding of non-dischargeability was substantially based on federalism. *See Kelly*, 479 U.S. at 47-49. However, the discharge of criminal restitution should also trigger an analysis of preemption, because bankruptcy law is exclusively federal and displaces state insolvency laws. *See infra* note 55 and Part IV.

23. *See, e.g.*, Perez v. Campbell, 402 U.S. 637, 648 (1971) (Congress intended the fresh start of bankruptcy to "include freedom from most kinds of pre-existing tort judgments.");

through restitutive sentences.[24] Bankruptcy rehabilitation provides financial, psychological, and social benefits to the debtor,[25] enabling her to resume participation in the credit economy without too much disruption to either her income[26] or property,[27] depending upon which chapter of the Bankruptcy Code she elects. The scheme of this broad discharge, which is not conditioned upon either the debtor's ability to repay debts[28] or the sanction of creditors, has evolved in response to the credit economy prevailing today, and is an integral part of our capitalistic system.[29] On the other hand, restitution rehabilitates the criminal by providing psychological awareness through repayment of the wrong done to the victim,[30] and allows the criminal to retain her liberty and thereby remain a productive member of society.[31] Restitution is an effective sentencing tool, and an integral part of our state criminal justice systems.[32] Thus, both bankruptcy and criminal restitution aim to rehabilitate and sustain functional actors within the bounds of our society and economy.

Criminal restitution, however, has a punitive aspect absent from bankruptcy discharge. When granted on the criminal's conviction, restitution often is a condition of probation.[33] By making the criminal com-

Local Loan Co. v. Hunt, 292 U.S. 234, 245 (1934) ("[V]arious provisions of the Bankruptcy Act were adopted in light of [the fresh start] and are to be construed . . . in harmony with it so as to effectuate the general purpose and policy of the Act.").

24. *See, e.g.*, CAL. PENAL CODE § 1203.1 (West Supp. 1992); People v. Richards, 17 Cal. 3d 614, 619-20, 552 P.2d 97, 100-01, (1976); People v. Miller, 256 Cal. App. 2d 348, 356, 64 Cal. Rptr. 20, 25 (1967).

25. *See infra* Part II.B for a discussion of the benefits of bankruptcy discharge.

26. In a Chapter 7, the debtor exchanges all non-exempt property for the discharge, keeping her future income. *See* 11 U.S.C. §§ 701-766 (1988 & Supp. II 1990). *See infra* Part II.C.1 for a discussion of the procedures and effect of a Chapter 7 case.

27. In the case of Chapter 13, the debtor is entitled to keep her property, exchanging this retained possession for her future wages through the Chapter 13 plan. *See* 11 U.S.C. §§ 1301-1330 (1988 & Supp. II 1990). *See infra* Part II.C.2 for a discussion of the procedures and effect of a Chapter 13 plan.

28. A discharge which is not contingent on the debtor's ability to pay is "unconditional." *See infra* Part II.D.3; Douglas G. Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 69, 73 (1982).

29. *See generally* Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 65-67 (1986) (discussing theories of the role of bankruptcy discharge in economy and society).

30. Richard E. Laster, *Criminal Restitution: A Survey of Its Past History and an Analysis of Its Present Usefulness*, 5 U. RICH. L. REV. 71, 80-82 (1970). "A system of restitution . . . serve[s] to keep the criminal-victim relationship alive long after the original offense so as to impress upon the mind of the criminal that he has injured a human being, not some impersonal entity known as the state." *Id.* at 80.

31. *Id.* at 81. "Custody conflicts with rehabilitation, if for no other reason than that the former forces a [person] to adjust to a different 'normal' society. One benefit of . . . restitution is that it . . . keep[s] the criminal within the normal society . . . ." *Id.* (footnote omitted).

32. *See infra* Part III, notes 282-300 and statutes collected therein.

33. *See, e.g.*, ALA. CODE § 12-14-13(d)(8) (1986); CAL. PENAL CODE § 1203.1 (West Supp. 1992); CONN. GEN. STAT. ANN. § 53a-30(a)(4) (West Supp. 1992); FLA. STAT. ANN.

pensate the victim, she literally must "pay" for her errant ways. Bankruptcy discharge has no such punitive connotations. Although bankruptcy may have a social "stigma,"[34] this stigma is rapidly disappearing as the number of bankruptcies increases and well-known, respected companies and individuals successfully emerge from bankruptcy.[35] Thus, while restitution punishes, bankruptcy discharge offers relief. This lack of a punitive aspect should not, however, require the exception of restitutive obligations from Chapter 13 bankruptcy discharge. Bankruptcy discharge is not entirely without cost. The debtor must surrender either future income under a Chapter 13 plan[36] or all non-exempt property in a Chapter 7 liquidation.[37] Because the debtor does "pay" for bankruptcy discharge, bankruptcy is not a free ride.

Nevertheless, if there is no change to Congress' explicit exception of criminal restitutive obligations from Chapter 13 bankruptcy discharge, as expressed in amended section 1328, we risk creating a modern form of debtor's prisons.[38] Because the criminal who cannot pay restitution may forfeit probation, incarceration is the result of the non-dischargeability of restitutive obligations.[39] But this frustrates the rehabilitative goals at the core of criminal restitution and bankruptcy discharge to return people to productive participation in the economy and society. The impetus behind Congress' explicit codification of the non-dischargeability of restitutive obligations—"[t]he bankruptcy laws are not a haven for criminal offenders"[40]—must be examined in light of the shared policy of rehabilitation behind restitution and discharge.[41]

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§ 947.181 (West Supp. 1992); MD. ANN. CODE art. 27, § 640(b) (Supp. 1991); TENN. CODE ANN. § 40-35-304(a) (1990).

34. Lisa J. McIntyre, *A Sociological Perspective on Bankruptcy*, 65 IND. L.J. 123, 129-33 (1989).

35. THERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 141 (1989) ("debtors in bankruptcy are not some 'other,' but part of mainstream America").

36. *See infra* Part II.C.2.

37. *See infra* Part II.C.1.

38. Debtors' prisons were designed to compel payment by the debtor, not to punish the debtor for failure to pay. The debtor was imprisoned until he forfeited his possessions. Jay Cohen, *The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153, 155-56 (1982). Most state constitutions now prohibit imprisonment for debt. *See, e.g.*, CAL. CONST. art. I, § 10 ("A person may not be imprisoned in a civil action for debt or tort . . . ."). Current bankruptcy law reflects that imprisonment is not an option for failure to pay debts.

39. *See* ALASKA STAT. § 12.55.051(a) (1990) (defendant may be imprisoned until restitution paid); ARIZ. STAT. ANN. § 13-810(b) (1989) (court may imprison defendant for bad faith failure to pay); FLA. STAT. ANN. § 775.089(4) (West Supp. 1992) (court may revoke probation if defendant fails to comply with restitution order).

40. H.R. REP. NO. 595, 95th Cong., 1st Sess. 342-43 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299; S. REP. NO. 989, 95th Cong., 2d Sess. 51-52 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5837.

41. This does not mean that discharge is the only aim of bankruptcy. Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1048 (1987). The

Part II of this Note discusses the evolution of consumer bankruptcy discharge and the policies it serves by exploring its history from the English bankruptcy antecedents relied on by Congress in the nineteenth century to its genesis in the Bankruptcy Act of 1898. Part II also examines the important role discharge has assumed in today's economy and details the discharge provisions of Chapters 7 and 13 for individual debtors to illuminate how this role is reflected in substantive law. Part III discusses restitution as a criminal sentencing device and the role it plays in the criminal justice system. Part IV addresses the concerns raised when federal bankruptcy courts interfere with state court criminal proceedings. Part V examines Congress' amendment to Bankruptcy Code § 1328 and explores the amendment's probable negative effect on debtor rehabilitation in light of discharge and restitution policies. Finally, Part VI proposes a solution to the conflicts between criminal restitution and discharge by focusing on their more important common goals, and uses current bankruptcy discharge provisions embodying more flexible provisions as a model for a suggested restitution discharge provision.

## II. Policy of the Bankruptcy Code

Today, federal bankruptcy law mediates between the competing needs of debtors and creditors. The bankruptcy process provides a collection device for creditors by assembling the debtor's assets and ensuring an equitable division among creditors,[42] while concurrently providing relief to debtors by granting a discharge of qualified debts.[43] The most recent ancestor of the Bankruptcy Code is the Bankruptcy Act of 1898.[44] The Bankruptcy Act allowed debtors to voluntarily seek haven in the bankruptcy courts, providing a discharge and a "fresh start."[45] How-

author lists five commonly cited purposes of bankruptcy proceedings: (1) to serve as a unified collection device for creditors; (2) to protect the "honest" debtor; (3) to protect particularly worthy creditors; (4) to rehabilitate the debtor; and (5) to achieve economic efficiency by distribution of the risk of loss between debtor and creditor. *Id.* These factors are discussed *infra* in Part II.B.

42. This is contrasted with state law, which provides "priority" in creditor status by using a "first come, first served" method. Whoever gets to the debtor's assets first through collection wins. This is particularly evident with reference to secured claims, which are prioritized according to time of perfection. *See* DAVID G. EPSTEIN, DEBTOR-CREDITOR LAW 137 (4th ed. 1991). When the debtor files for bankruptcy, state law collection efforts are barred by the automatic stay and the bankruptcy process takes over. 11 U.S.C. § 362 (1988 & Supp. II 1990); *see infra* note 55.

43. 11 U.S.C. § 727 (1988) (Chapter 7); 11 U.S.C. § 1328 (1988 & Supp. II 1990) (Chapter 13).

44. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682. For purposes of distinction in this Note the Bankruptcy Act of 1898 will be referred to as the "Bankruptcy Act" or the "Act," and the Bankruptcy Reform Act of 1978 will be referred to as the "Bankruptcy Code" or the "Code."

45. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934). *Local Loan* was decided under

ever, the Bankruptcy Act was merely one step in the evolution of the United States bankruptcy system. This evolution took place over a long period of time, and reflects a number of economic and legal choices made by Congress and the courts to accommodate the need for financially healthy participants in our credit economy.[46]

The basic structure of creditor payment and debtor relief found in modern United States bankruptcy law evolved from the English system of bankruptcy.[47] The rudimentary English system was very limited, providing a discharge of debts only for certain classes of debtors (traders and merchants),[48] and was "involuntary"—only creditors could commence a bankruptcy case.[49] The English system was notorious for its debtors' prisons, used to coerce payment from the debtor.[50] Debtor relief was non-existent, because there was no discharge of debts.[51] Thus, the early English system was creditor-oriented and punitive with respect to the debtor.[52]

The modern Bankruptcy Code is far removed from its English antecedents. Section A of this Part discusses the various policy considerations that have shaped today's complex and forgiving debtor discharge provisions, so that the Bankruptcy Code's policies can be understood in relation to those underlying criminal restitution. Section B addresses the role discharge plays in the credit economy today and its importance to the smooth functioning of that economy. Section C discusses the discharge provisions of the current Bankruptcy Code, under both Chapter 7 and Chapter 13, and how these chapters implement the "fresh start" ideal. Section D discusses the various exceptions to discharge and their rationale in order to illustrate the policy considerations which should underlie any exception to discharge, such as the one Congress has embodied in its amendment to § 1328.

### A. Evolution of United States Bankruptcy Law

The Constitution provides that the federal government has the power to prescribe uniform bankruptcy laws.[53] When drafting the Con-

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the Bankruptcy Act, which was in effect until October 1, 1979, when it was replaced by the Bankruptcy Code. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682.

46. COMMISSION REPORT, *supra* note 10, at 71.

47. COMMISSION REPORT, *supra* note 10, at 63; Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 1 (1940).

48. Cohen, *supra* note 38, at 156.

49. *Id.* at 155.

50. *Id.* at 155-56.

51. *Id.* at 156.

52. *Id.* at 154 (debtor without property could be imprisoned until he reached an agreement with creditors, and creditors could require continued imprisonment).

53. U.S. CONST. art. I, § 8, cl. 4. ("The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies . . . ."). The purpose of the Bankruptcy Clause is

stitution, the framers contemplated that these laws would resemble the English bankruptcy system then in existence.[54] Over the next 110 years, various federal bankruptcy laws were enacted and repealed.[55] Finally, in 1898, Congress enacted the Bankruptcy Act,[56] which remained in effect, with amendments,[57] until the 1978 enactment of the Bankruptcy Reform Act,[58] which contains today's Bankruptcy Code.[59]

The English model upon which early American bankruptcy laws were patterned traditionally supplied proceedings only for trader and merchant debtors[60] and granted no discharge.[61] Early English proceed-

obscured in history, although it appears that the framers hinged its importance on the function of commerce between the states and sought to regulate bankruptcy at a federal level in order to facilitate commerce. CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 7 (Da Capo Press 1972) (1935).

54. The first national bankruptcy law was the Bankruptcy Act of 1800. Ch. 19, 2 Stat. 19 (repealed 1803). This law contemplated an involuntary proceeding initiated by creditors and was confined to debtors were who merchants and traders. Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 228 (1976). Creditors were required to allege an "act of bankruptcy," which included flight, "concealment" of the debtor, or disposal of property with intent to defraud or delay. *Id.* The Bankruptcy Act of 1800 was repealed in 1803, as it was considered only a temporary measure. Act of Dec. 19, 1803, ch. 6, 2 Stat. 248; Countryman, *supra* at 228.

55. The Bankruptcy Act of 1800 was followed by the Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843), which extended relief to all individuals, not just merchants. Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 941 n.1 (1979). Although the main reason for the 1841 Act was the panic of 1837, it was repealed in 1843 due to creditor dissatisfaction with the large number of discharges. Act of Mar. 3, 1843, ch. 82, 5 Stat. 614; Countryman, *supra* note 54, at 229. The next attempt at a bankruptcy act occurred in 1867, and resulted from the economic upheavals generated by the Civil War. *See* Bankruptcy Act of 1867, ch. 17b, 14 Stat. 517 (repealed 1878). The 1867 Act was the first bankruptcy legislation to grant relief to corporations. Countryman, *supra* note 54, at 229. However, the 1867 Act was repealed in 1878, again due to creditor dissatisfaction. Act of June 7, 1878, ch. 160, 20 Stat. 99; Countryman, *supra* note 54, at 230.

During the period in which no federal bankruptcy statute was in effect, the states were free to govern bankruptcy proceedings. COMMISSION REPORT, *supra* note 10, at 64. Conversely, when federal bankruptcy laws have been enacted, "constitutional exclusivity has been invoked against the states maintaining comparable legislation. The constitutional provision does not extend, however, to void state insolvency laws. Consequently, there has been continuing judicial construction of the line where insolvency laws end and bankruptcy legislation begins." *Id.*

56. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682.

57. The most notable amendment was the Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, though the Bankruptcy Act was revised over sixty times prior to repeal in 1978. The Chandler Act sought to curb dishonest bankruptcies, improve administrative efficiency, and most notably added the rehabilitative provisions of Chapter XIII. John E. Mulder, *Ambiguities in the Chandler Act*, 89 U. PA. L. REV. 10, 13-14 (1940).

58. Pub. L. No. 95-598, 92 Stat. 2549 (1978).

59. 11 U.S.C. §§ 101-1330 (1988 & Supp. II 1990).

60. John C. McCoid II, *The Origins of Voluntary Bankruptcy*, 5 BANKR. DEV. J. 361, 361 (1988).

61. Discharge did not enter English bankruptcy law until 1705. *See* Countryman, *supra*

ings were also involuntary,[62] and the debtor was often imprisoned.[63] The debtor was only able to obtain release from prison by paying his debts.[64] These proceedings served primarily as a mechanism for the collection of debts and distribution of the debtor's assets to creditors.[65] An important landmark was reached in 1705, when English law introduced discharge.[66] Imprisonment also declined as courts recognized that an employed debtor could pay more promptly than one in prison.[67]

During the nineteenth century, American bankruptcy laws underwent several metamorphoses that distanced them from their English predecessors. Bankruptcy law was in a state of flux during this period; the bankruptcy laws that were enacted often were quickly repealed in the face of political opposition. The changes that did take place during this period, however, recognized the importance of debt relief and, thus, were characterized by the greater availability of an enhanced discharge. Although debtors' prisons existed in the United States well into the 1840s,[68] they suffered a decline at the hands of reformers and were prohibited by many state constitutions during this period as recognition of their futility led to their abolishment.[69] The 1841 Bankruptcy Act was the first American law to provide for discharge in the context of voluntary proceedings for merchants and non-merchants.[70] This Act also allowed the debtor to retain certain necessary property.[71] The 1841 Act was short-lived, however, and was repealed in 1843. The Civil War and resulting financial upheavals provided the impetus for the Bankruptcy Act of 1867,[72] which permitted voluntary proceedings for merchants,

note 54, at 227 (citing An Act to prevent Frauds frequently committed by Bankrupts, 4 & 5 Anne, ch. 17 (1705) (Eng.)).

62. McCoid, *supra* note 60, at 361 n.4 (English law did not allow voluntary bankruptcy until 1849). American law followed this tradition: the Bankruptcy Act of 1800 provided only for involuntary proceedings. Countryman, *supra* note 54, at 228.

63. *See* Cohen, *supra* note 38, at 153 (imprisonment for debt used intermittantly in England for over 600 years).

64. Countryman, *supra* note 54, at 227.

65. Cohen, *supra* note 38, at 156.

66. An Act to prevent Frauds frequently committed by Bankrupts, 4 & 5 Anne, ch. 17, § 8 (1705) (Eng.). However, this discharge was not rehabilitative in character but rather an incentive for the debtor to disclose his assets to his creditors for collection. Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1395 n.5 (1985).

67. Cohen, *supra* note 38, at 159.

68. *See* Countryman, *supra* note 54, at 229; *see also* McIntyre, *supra* note 34, at 126 (three out of eight residents of Philadelphia spent time in debtor's prisons in the 1820s) (quoting PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900, at 287-88 (1974)).

69. Countryman, *supra* note 54, at 229; *cf.* Cohen, *supra* note 38, at 159 (English law recognized that confined debtors were unable to pay debts; releasing debtors would facilitate creditor payment).

70. Ch. 9, 5 Stat. 440 (repealed 1843).

71. Countryman, *supra* note 54, at 229.

72. Ch. 176, 14 Stat. 517 (repealed 1878).

non-merchants, and corporations.[73] The 1867 Act provided exemptions for necessaries and denied discharge for certain specified acts. The debtor's discharge, however, was granted for good behavior *regardless* of creditor consent.[74] This Act was repealed in 1878 because of both creditor opposition to the expanded pro-debtor provisions and regional opposition.[75]

The increasing desire to grant relief to overburdened debtors[76] that resulted from the emergence of the nineteenth century industrialized economy culminated in the Bankruptcy Act of 1898.[77] The 1898 Act provided as much relief for debtors as the prior acts, but included "compositions" (repayment plans)[78] and special provisions for important industrial companies, such as railroads.[79] Thus, bankruptcy proceedings had become available to all parties, not only traders and merchants.[80] Additionally, the 1898 Act did not consider ability to repay as a condition to granting discharge.[81] Instead, the 1898 Act formally recognized that debtor relief, and not solely creditor repayment, was a legitimate objective of bankruptcy.[82] As the bias against discharge gradually abated[83] and a policy of favoring a debtor's return to participation in the economy emerged as a goal of bankruptcy law,[84] the focus of bankruptcy

73. Countryman, *supra* note 54, at 229.

74. *Id.* at 230.

75. Act of June 7, 1878, ch. 160, 20 Stat 99; Countryman, *supra* note 54, at 230; William M. Wiecek, *The Reconstruction of Federal Judicial Power, 1863-1875*, 13 J. AM. HIST. 333, 357 (1969). The regional opposition to the 1867 Act reflected the continuing antagonism between the North and South following the Civil War. Northern "creditors felt that the [1867] [A]ct was too lenient on Southern debtors. Southerners and westerners voiced their instinctive fears of federal courts and national laws providing for the collection of debts." Wiecek, *supra* at 357.

76. Hallinan, *supra* note 29, at 56. Hallinan notes that the expanded political power of entrepreneurs created a change in societal attitudes towards borrowing. The economic risks inherent in borrowing were detached from notions of dishonest and irresponsible use of credit. *Id.*

77. Ch. 541, 30 Stat. 544 (1898), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682.

78. Ch. 541, 30 Stat. 544; Countryman, *supra* note 54, at 231.

79. Ch. 541, 30 Stat. 544; Countryman, *supra* note 54, at 231.

80. The second bankruptcy act made relief available to all parties unable to meet their financial obligations. Bankruptcy Act of 1841, ch. 9, 5 Stat. 440, 441 (repealed 1843); *see also* McCoid, *supra* note 60, at 361-62.

81. Bankruptcy Act of 1898, ch. 541, § 14, 30 Stat. 544, 550, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682; *see also* Hallinan, *supra* note 29, at 60.

82. Ch. 541, 30 Stat. 544; Hallinan, *supra* note 29, at 60.

83. Hallinan, *supra* note 29, at 57 (debtor's position was now viewed as the result of "misfortune rather than blameworthiness").

84. *Id.* at 62-64.

law shifted to debtor interests as the value of debtor rehabilitation was recognized.[85]

Furthermore, bankruptcy legislation at a federal level was crucial to the emerging industrialized economy. As Madison had recognized over 100 years earlier, a uniform federal bankruptcy law was an important component of the federal government's need to control and promote commerce.[86] The various nineteenth century state insolvency laws created regional turmoil, threatened the growth and prosperity of the emerging industrial economy, and led to recognition of the need for a uniform, federal law.[87] In 1935 the Supreme Court upheld the constitutionality of the Bankruptcy Act, explicitly recognizing the departure that had occurred from the English model[88] and the need to accommodate the tremendous growth in the industrial economy.[89] The Bankruptcy Act of 1898 represents the first evidence of maturation of the bankruptcy process from the limited, creditor-aligned English model to the broad debtor-relief provisions familiar today.[90]

### B. Bankruptcy Law Today: The "Fresh Start"[91]

The 1898 Bankruptcy Act, however, was not resilient enough to accommodate further changes in the economy, most notably the rise of

85. Boshkoff, *supra* note 28, at 109-10 (" '[T]he State is more interested in having an honest debtor relieved from obligations he can not meet, and given an opportunity to better support and educate his family . . . , than in having him held in financial bondage forever by individual creditors.' ") (quoting 30 CONG. REC. 603 (1898) (statement of Sen. Lindsay)).

86. WARREN, *supra* note 53, at 7 (quoting THE FEDERALIST No. 42 (James Madison)).

87. If the debtor's property was in several different states, each without jurisdiction over property in another state, judgments could not be enforced. State collection actions were thus of limited effectiveness. COMMISSION REPORT, *supra* note 10, at 64. *See also* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 258-68 (1827) (an early recognition that state-granted debtor discharge was no defense in a sister state collection action); 1 COLLIER ON BANKRUPTCY ¶¶ 0.01-07 (James W. Moore ed., 14th ed. 1974). The author notes:

> The main inadequacy of the state insolvency laws . . . was the inability to give a discharge which would be effective in other states.
>
> It was inevitable that Congress would be called upon to exercise its legislative power over the subject of bankruptcies. An expanding commercial union would require it; financial stringency would accelerate the demand. This latter element has been the culminating factor in producing the Acts of 1800, 1841, 1867 and 1898 . . . .

*Id.* ¶ 0.03. However, at no time did federal bankruptcy laws supplant state collection remedies. *See* COMMISSION REPORT, *supra* note 10, at 64.

88. Continental Ill. Nat'l Bank & Trust Co. v. Chicago, Rock Is. & Pac. Ry., 294 U.S. 648, 669 (1935) (power of Congress under Bankruptcy Clause not limited by English law); *see also* Countryman, *supra* note 54, at 231.

89. Countryman, *supra* note 54, at 231 (quoting *Continental Ill. Nat'l Bank*, 294 U.S. at 669, 671-72).

90. This is reflected by the fact that the Bankruptcy Act remained in effect, with amendments, until passage of the Bankruptcy Code in 1978, and provided the framework for bankruptcy during most of the twentieth century.

91. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

individual consumer bankruptcies after World War II.[92] In the late 1960s, the Brookings Institution undertook an empirical study which revealed that the Bankruptcy Act was inadequate to meet the modern needs of debtors and creditors.[93] In 1970, Congress established the Commission on the Bankruptcy Laws of the United States[94] to conduct a similar analysis. The findings of the Brookings Institution and the Bankruptcy Commission were very similar[95] and revealed problems in the administration of bankruptcy cases, including: an increasing use of consumer bankruptcies after World War II that burdened the system,[96] non-uniform use of Chapter XIII provisions,[97] and administrative inefficiencies resulting in trivial benefits to creditors.[98] Further, procedural rules that conflicted with the Bankruptcy Act effectively nullified many substantive provisions of the Act, impairing the bankruptcy courts' effectiveness.[99] Lastly, because much of the substantive law applied in bankruptcy proceedings relied on state provisions, the Bankruptcy Act was a "hodgepodge" and thus administratively inadequate to meet the needs of creditors and debtors.[100] The Bankruptcy Commission's report led to a complete overhaul of the Bankruptcy Act, culminating in the Bankruptcy Reform Act of 1978.[101]

92. Congress noted the problems occasioned by the growth in the number of consumer debtors: "In the post-War years, consumer credit has become a major industry, and buying on time has become a way of life for a large segment of the population. The bankruptcy rate among consumers has risen accordingly, *but without the required provisions in the Bankruptcy Act to protect those who need bankruptcy relief.* This bill [the new Bankruptcy Code] makes bankruptcy a more effective remedy . . . ." H.R. REP. No. 595, 95th Cong., 1st Sess. 4 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5966 (emphasis added).

93. *See* DAVID T. STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM (1971) (Brookings Institution report).

94. Pub. L. No. 91-354, 84 Stat. 468 (1970) (Bankruptcy Study Commission).

95. GEORGE M. TREISTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW 1 (2d ed. 1988).

96. COMMISSION REPORT, *supra* note 10, at 2.

97. *Id.* at 4.

98. *Id.* at 3.

99. TREISTER, *supra* note 95, at 3. The Supreme Court promulgated Rules of Bankruptcy Procedure that superseded any contrary provision in the Bankruptcy Act if the rule concerned a matter of "practice or procedure." Treister notes that "[s]ince a considerable portion of [the Bankruptcy] Act was in the nature of 'practice and procedure,' many of its provisions were, in effect, repealed by the Bankruptcy Rules . . . . The courts and lawyers were left to determine for themselves which portions of the Act were 'substantive' and therefore still effective." *Id.*

100. *Id.* at 5. "[N]o wholesale reexamination of the bankruptcy law had taken place to determine whether the dual bankruptcy principles of fairness in the treatment of creditors and the grant of a fresh start to the debtor were being served by the use of state substantive provisions." *Id.*

101. Pub. L. No. 95-598, 92 Stat. 2549. Many of the changes wrought by the Bankruptcy Reform Act are beyond the scope of this Note, but certain salient features should be noted. Under the Act, the bankruptcy judges (designated as "referees" and appointed by district court judges to six-year terms) were heavily involved in the minute administrative aspects of the

*(1) Bankruptcy Reform Act of 1978*

The Bankruptcy Code[102] provides five avenues of relief to an insolvent debtor: (1) Chapter 7,[103] or liquidation, in which the debtor's nonexempt[104] assets are liquidated and the proceeds distributed to creditors pro-rata, with the debtor receiving a discharge;[105] (2) Chapter 9, which provides relief for municipalities;[106] (3) Chapter 11 reorganizations for individuals, partnerships, and corporations;[107] (4) Chapter 12, which

case, which the Commission found detracted from the referees' "judicial objectivity." COMMISSION REPORT, *supra* note 10, at 93-94. The Bankruptcy Reform Act removed much administrative responsibility from the referees, and they were designated as "bankruptcy judges," appointed by the President to 14-year terms, and given broader powers. TREISTER, *supra* note 95, at 23-25.

The lack of tenure of the new bankruptcy judges subjected the Bankruptcy Courts to a constitutional attack in Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), as an impermissible delegation of Article III power to an Article I court. The *Northern Pipeline* decision was stayed to enable Congress to restructure the bankruptcy courts. A second three-month stay was granted after Congress failed to act, and when the second stay expired, the ruling of *Northern Pipeline* took effect. The Judicial Conference then recommended a model Emergency Rule to govern bankruptcy proceedings until Congress took action. The Supreme Court upheld the validity of the Emergency Rule, and in the meantime, Congress reformulated bankruptcy courts' jurisdiction. TREISTER, *supra* note 95, at 25-33.

The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (hereinafter BAFJA), sought to correct some of the problems raised by *Northern Pipeline*. BAFJA vested district courts with primary bankruptcy jurisdiction, with the bankruptcy courts as "adjuncts." Since the district courts were Article III courts, this overcame the problem of *Northern Pipeline*. Today "the bankruptcy judges . . . constitute a unit of the district court to be known as the bankruptcy court for that district." 28 U.S.C. § 151 (1988); TREISTER, *supra* note 95, at 33. BAFJA's changes relating to Chapter 7 and 13 bankruptcies that are pertinent to this Note are explored *infra* in Part II.C.

102. 11 U.S.C. §§ 101-1330 (1988 & Supp. II 1990).

103. 11 U.S.C. § 701-766 (1988).

104. Exemptions are specified in 11 U.S.C. § 522 (1988 & Supp. II 1990). Exemptions assist the debtor in obtaining a fresh start by enabling the debtor to keep specified property (or income, in the case of a Chapter 13) to provide a foundation for the future. Steven L. Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law In Perspective*, 30 UCLA L. REV. 327, 340-41 (1982) (The "fresh start is an appropriate goal of bankruptcy law and . . . exemptions are supposed to promote that goal."). Property (or income) exempted is beyond the reach of creditors, since it is no longer part of the debtor's estate. TREISTER, *supra* note 95, at 299. The Bankruptcy Act relied exclusively on state law to define what property would be exempt, which resulted in many inconsistencies. The Commission established to study bankruptcy in 1970 recommended a national exemption system. *See* Pub. L. No. 91-354, 84 Stat. 468 (1970). A compromise was reached, (1) allowing the debtor to choose between the federal or state exemptions, and (2) allowing the states to opt out of the federal exemption scheme, thus requiring debtors to use the state exemptions. Nearly three-fourths of the states have opted out of the federal scheme. TREISTER, *supra* note 95, at 299-301. The scope of such state exemption statutes is beyond the scope of this Note. *See infra* note 170 for a discussion of particular federal exemptions.

105. 11 U.S.C. § 727 (1988).

106. 11 U.S.C. §§ 901-946 (1988).

107. 11 U.S.C. §§ 1101-1174 (1988). The debtor's business is rehabilitated as a going con-

provides relief for family farmers;[108] and (5) Chapter 13, which provides relief for individual debtors with specified incomes and requires repayment to creditors.[109] The bankruptcy court has broad jurisdiction over cases,[110] civil proceedings,[111] and property,[112] and is the only place debtor relief may be granted.[113]

Today, bankruptcy law is often characterized as having the twin purposes of providing for efficient debt collection and granting debtor relief through discharge.[114] As a debt collection device, bankruptcy provides equitable treatment for creditors and avoids the race between creditors to collection that often results under state insolvency laws.[115] Debtor relief is a distinct and independent policy of modern bankruptcy law:[116] the debtor need not be insolvent to petition for relief,[117] and theo-

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cern through the plan of reorganization, and provides a fresh start through the binding effect of the plan. TREISTER, *supra* note 95, at 17.

108. 11 U.S.C. §§ 1201-1231 (1988). Chapter 12, enacted in 1986, was designed to be a temporary remedy to alleviate the farming crisis of the 1980s and is due to expire on October 1, 1993. TREISTER, *supra* note 95, at 17.

109. 11 U.S.C. §§ 1301-1330 (1988 & Supp. II 1990).

110. 28 U.S.C. § 1334(a) (1988). What constitutes a bankruptcy case is subject to debate, but includes the bankruptcy petition and the proceedings on the petition. TREISTER, *supra* note 95, at 35. Bankruptcy courts exercise such jurisdiction pursuant to a district court's referral under 28 U.S.C. § 157(a) (1988).

111. 28 U.S.C. § 1334(b) (1988). This subsection gives district courts original but not exclusive jurisdiction over civil proceedings which arise under Title 11 (the Bankruptcy Code). Practically speaking, this includes adversary matters "relating" to the bankruptcy case. TREISTER, *supra* note 95, at 37-43.

112. 28 U.S.C. § 1334(d) (1988). This provision gives district courts "exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate." *Id.* This provision reflects the fact that bankruptcy courts are primarily vehicles for in rem actions to determine the rights to property. TREISTER, *supra* note 95, at 43.

113. 28 U.S.C. § 1334(a) (1988). Subsection 1334(a) gives district courts "original and exclusive jurisdiction of all cases under title 11" (the Bankruptcy Code). Because bankruptcy courts are adjuncts to district courts, their jurisdiction under 28 U.S.C. § 1334 shall be referred to as bankruptcy court jurisdiction. See *supra* note 101.

114. *See, e.g.*, Vickie L. Vaska, Comment, *Property of the Estate After Confirmation of a Chapter 13 Repayment Plan: Balancing Competing Interests*, 65 WASH. L. REV. 677, 678 (1990) (articulating dual goals of Chapter 13 proceedings).

115. Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. 99, 114 & n.144 (1990) (bankruptcy eliminates "costly and competitive collection efforts facing multiple creditors under state law").

116. Jackson, *supra* note 66, at 1395-96.

117. The Code defines "insolvency" as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of . . . property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors . . . [and] property that may be exempted from property of the estate under section 522 . . . ." 11 U.S.C. § 101(32)(A) (Supp. II 1990). Further, "[t]here is nothing in the Act which requires the person to be insolvent, and there seems to be no reason why, if a solvent person cares to have his property distributed among his creditors through bankruptcy proceedings, he should not be allowed to do so . . . ." 1 COLLIER ON BANKRUPTCY *supra* note

retically discharge could be granted without providing any debt collection for creditors. This Note is concerned with the discharge policy of bankruptcy; its merits as a collection device are considered only as it relates to the granting of discharge.

*(2) The Costs and Benefits of Discharge*

The bankruptcy courts' scope and power is a function of the importance of bankruptcy proceedings to the economy's efficient performance. Today, bankruptcy is viewed as a normal and integral part of a capitalistic economy.[118] Bankruptcy discharge is central to maintaining a smoothly functioning credit economy;[119] an economy functions best with the highest possible number of healthy participants.[120] Bankruptcy discharge, therefore, promotes economic rehabilitation of debtors by providing a fresh start so debtors can continue to participate in the economy.

There are many theories regarding the role of discharge in bankruptcy and its relation to the complex economic and social factors comprising our capitalistic society.[121] For example, discharge can be viewed as the individual counterpart of a corporation's limited liability.[122] Nevertheless, the salient purposes of the bankruptcy discharge are financial rehabilitation of the debtor[123] and her return to productive participation in the open credit market.[124] The relief afforded by bankruptcy recognizes that a productive individual is worth more to society than a destitute person.[125]

The benefits of discharge, however, are not without cost. Discharge to debtors results in financial loss to creditors through unpaid debts, and

87, ¶ 4.03, at 580-81; *see also* 11 U.S.C. § 109 (1988) (in defining who may be a debtor under Chapters 7 and 11 of the Bankruptcy Code, no mention is made of insolvency).

118. McIntyre, *supra* note 34, at 127; *see also* SULLIVAN ET AL., *supra* note 35, at 6 (portraying bankruptcy as a hospital for the financially sick). This economic model, however, is not all-inclusive; other factors are at work. *See infra* Part II.B.

119. In fact, bankruptcy discharge is so important that a debtor cannot waive his right to receive a discharge in advance of bankruptcy proceedings in order to obtain credit. *See generally* Jackson, *supra* note 66, at 1394.

120. "[S]ociety needs the activity of every one of its members; . . . while a man, whose earnings are entirely at his creditors' mercy, would be little disposed to work, he might, if freed from this burden, retrieve his reputation and become a valuable member of the community." Hallinan, *supra* note 29, at 57 n.24 (citing Edwin S. Mack, *Bankruptcy Legislation*, 28 AM. L. REV. 1, 5 (1894)).

121. *See, e.g.*, Hallinan, *supra* note 29, at 96; Hillman, *supra* note 115, at 109; Howard, *supra* note 41, at 1069; Jackson, *supra* note 66, at 1398.

122. Jackson, *supra* note 66, at 1400.

123. Grogan v. Garner, 111 S. Ct. 654, 659 (1991) ("[A] central purpose of the Code is to [permit] debtors [to] reorder their affairs, [and] make peace with their creditors . . . ."); NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) ("[P]olicy of Chapter 11 is to permit successful rehabilitation of debtors.").

124. COMMISSION REPORT, *supra* note 10, at 71.

125. Hillman, *supra* note 115, at 111.

creditors must accommodate this loss. Creditors, who profit from their loans, are naturally willing to bear the risk of some loss through discharge to ensure that they have many loan "customers."[126] Consumers' knowledge that they can obtain a discharge if overburdened alleviates their fears of ruthless collection methods, and encourages them to obtain credit.[127] While discharge results in higher credit costs for the average consumer,[128] the presence of bankruptcy discharge has not deterred creditors from granting credit.[129] Instead, the costs of discharged debt are spread among the population in the form of higher interest rates.[130] Borrowers, in turn, tolerate these higher rates because they recognize the financial benefits bankruptcy may provide if the need arises.[131]

Some commentators, however, maintain that bankruptcy discharge may encourage bankruptcy and careless borrowing.[132] The economic model which posits that creditors are better risk bearers of financial problems ignores the fact that debtors may be in a better position to evaluate their own financial health.[133] Borrowers' awareness of the safety net of discharge may encourage profligate spending and a subsequent resort to bankruptcy, because debtors know they have already "paid" for their

126. In the context of the possibility of loan defaults and bankruptcy, higher credit costs are a form of risk allocation. Creditors may be in a better position to evaluate the risks due to their experience and ability to accumulate and evaluate default statistics. They can thus insure against loan default by spreading default costs among all borrowers. *See, e.g.,* Hallinan, *supra* note 29, at 98. However, one could argue that debtors are in just as good a position to evaluate their risk of loan default. *See* Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953, 981-83 (1981) (arguing that debtors may be better able to assess likelihood of default and that some lenders are at an informational disadvantage vis-a-vis debtors).

127. Discharge "provides the debtor with credit insurance coverage in an amount equal to his dischargeable liabilities .... the collections consequences of non-payment [are] more burdensome to him than whatever burdens might accompany his resort to bankruptcy." Hallinan, *supra* note 29, at 100.

128. Eisenberg, *supra* note 126, at 983.

129. Given the dismal collections obtained by creditors once a borrower files for bankruptcy, it is not surprising that creditors must account for discharge "costs." For example, 97% of Chapter 7 liquidations result in no dividend to creditors, and the average Chapter 13 provides payment of approximately 57% of debts. The effective focus of consumer bankruptcies is thus not on debt collection but discharge, which leaves creditors to suffer the loss. U.S. GENERAL ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, COMMITTEE ON THE JUDICIARY, HOUSE OF REPRESENTATIVES, BANKRUPTCY REFORM ACT OF 1978—A BEFORE AND AFTER LOOK 45 (1983).

130. Hillman, *supra* note 115, at 126. The various economic theories by which creditors allocate the risk of discharge are beyond the scope of this Note. For a comprehensive discussion, see Hallinan, *supra* note 29, at 98.

131. Jackson, *supra* note 66, at 1415; Howard, *supra* note 41, at 1067 ("One way of viewing the added cost [higher interest rates] is as an insurance premium, paid by all users of credit to insure their own access to bankruptcy relief in the event of financial disaster.").

132. Hallinan, *supra* note 29, at 66; Hillman, *supra* note 115, at 126-27 (debtor may not bear total cost of his own bankruptcy discharge because discharge cost in form of higher interest rates is distributed among *all* creditors).

133. Eisenberg, *supra* note 126 at 981-83; Hillman, *supra* note 115, at 126.

own discharge.[134] Bankruptcy discharge may also undermine the sanctity of contract,[135] although contract law does recognize "excuse" as a defense to performance.[136]

The Bankruptcy Code deals with these "moral hazards"[137] in its discharge exception provisions, which limit debt relief by providing it only to those debtors who have acted without fraud or deceit, and the Code excludes from discharge certain debts for policy reasons.[138] These exceptions safeguard the bankruptcy process by ensuring that it will be used only by the "honest" but overburdened debtor.

Bankruptcy discharge also serves non-economic ends. Discharge provides an emotional purgative from the oppression of debt; the sheer magnitude of overwhelming debt can be demoralizing.[139] Discharge provides freedom from the dishonor of the inability to pay debts, provides a psychological haven from creditors[140] and renews the debtor's optimism and self-confidence.[141] Indeed, a debtor's potential discharge or acute insolvency may actually reduce pre-bankruptcy creditor collection efforts, giving the debtor an added psychological bonus.[142] The judicial sanction of discharge and the act of surrendering one's assets[143] or future income[144] allows the debtor to feel entitled to society's forgiveness.[145]

134. Hillman, *supra* note 115 at 126-27; Jackson, *supra* note 66, at 1402. Jackson states that bankruptcy "discharge imposes much of the risk of ill-advised credit decisions not on social insurance programs but on creditors." *Id.* Jackson notes that this is the "moral hazard" problem, which results when individuals "undervalue the costs of engaging in risky activities today because they can depend on society to bear a portion of the costs that may arise tomorrow." *Id.*

135. Hillman, *supra* note 115, at 134.

136. Indeed, contract excuse and bankruptcy discharge are analogous in that both reflect equitable considerations in relieving unfortunate participants. *See generally id.* (discussing the value of the approach of contract excuse to bankruptcy discharge analysis).

137. *See supra* note 134; Jackson, *supra* note 66, at 1402.

138. 11 U.S.C. § 523 contains the exceptions to discharge. 11 U.S.C. § 523 (1988 & Supp. II 1990). The policy considerations underlying these exceptions are discussed *infra* in Part II.D.1.

139. Jackson, *supra* note 66, at 1421 (suggesting that debtors would be inclined to substitute leisure time for gainful employment if their debts were too large to pay).

140. The automatic stay provisions of the Bankruptcy Code give the debtor breathing room from collection proceedings while she reorganizes her affairs. *See* 11 U.S.C. § 362(a) (1988); *see also* TREISTER, *supra* note 95, at 195 ("[P]urpose of automatic stay is to give the . . . debtor some 'breathing time' for rehabilitation.").

141. Hillman, *supra* note 115, at 124; Howard, *supra* note 41, at 1061; Jackson, *supra* note 66, at 1406.

142. Marjorie L. Girth, *The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals*, 65 IND. L.J. 17, 28 (1989) (creditors may forego collection efforts of debtors with no assets).

143. Chapter 7 provides a discharge in exchange for surrender of the debtor's non-exempt assets. *See infra* Part II.C.1.

144. Chapter 13 grants a discharge in exchange for the debtor surrendering her future income to pay creditor claims. *See infra* Part II.C.2.

145. Hillman, *supra* note 115, at 120.

The broad scope of modern bankruptcy discharge represents a shift away from the stigma of insolvency to a recognition of debtors as sympathetic victims of events beyond their control and worthy of rehabilitation.[146] The federalization of bankruptcy laws has furthered the decline of bankruptcy's emotional stigma by "legitimizing" discharge.[147]

Although resort to bankruptcy is, as a practical matter, relatively simple,[148] it does not occur as frequently as the purely economic analysis would suggest. Some insolvents, due to the residual emotional and social stigma of bankruptcy, stubbornly refuse to file bankruptcy even when it would be in their best financial interests.[149] Refusal to file contravenes what the economic model suggests: when the benefits of bankruptcy outweigh the costs, people will opt for bankruptcy.[150] The Bankruptcy Code recognizes this potential stigma and attempts to ameliorate its effects in order to promote the fresh start. For example, § 525 prohibits the government from discriminating against former debtors in employment or in the grant of licenses.[151] This discrimination prohibition also extends to private parties, who may not terminate or discriminate against an employee because of a prior bankruptcy proceeding.[152] These Code provisions reflect a policy that bankruptcy should not stigmatize debtors in the employment arena, because to do so would subvert the fresh start policy by inhibiting debtors' return to full economic productivity.

*(3) The Net Social and Economic Benefit of Discharge*

In spite of the negative factors attendant to bankruptcy discharge, the need for it is not seriously questioned.[153] By placing the risk of loss on creditors, discharge protects unsuspecting debtors from questionable

146. *Id.* at 112 (debtors need protection from "wily creditors").

147. *Id.* at 128.

148. The debtor need only file a petition, and the right to relief is not conditioned on any purely financial factors, such as ability to pay or assets. *See supra* note 117.

149. McIntyre, *supra* note 34, at 129-30. Studies have shown that up to 65% of unpaid debts are owed by debtors who have not filed bankruptcy. *Bankruptcy Reform Act of 1978: Hearings before the Subcomm. on Courts of the Senate Comm. on the Judiciary,* 97th Cong., 1st Sess. 34 (1981).

150. McIntyre, *supra* note 34, at 128-29.

151. 11 U.S.C. § 525(a) (1988); *see* Perez v. Campbell, 402 U.S. 637, 654 (1971) (holding that state may not refuse to renew driver's license of debtor when debtor received discharge of tort judgment, because to do so would frustrate fresh start policy).

152. 11 U.S.C. § 525(b)(1)-(3) (1988).

153. Howard, *supra* note 41, at 1047 & n.4 (discharge provisions have been part of every bankruptcy statute passed by Congress). Criticisms of bankruptcy discharge focus not on whether we should have it at all, but on various particular shortcomings, some of which are discussed *supra* in Part II.B and *infra* in Part II.C. For some discussions of bankruptcy discharge and its various aspects, see Hallinan, *supra* note 29; Hillman, *supra* note 115; Jackson, *supra* note 66; Jack L. Van Baalen, *Bankruptcy Code Chapter 13—What Price the "Better Discharge"?*, 35 OKLA. L. REV. 455 (1982); John C. Weistart, *The Costs of Bankruptcy,* LAW & CONTEMP. PROBS., Autumn 1977, at 107, 108.

credit collection efforts, a benefit for which consumers are willing to pay with increased credit rates.[154] Further, discharge has a paternalistic aspect in relieving debtors from the results of imprudent and ill-advised conduct, the risks of which they are poorly equipped to evaluate and appreciate fully.[155] Most importantly, discharge prevents costly social externalities by keeping debtors off the welfare rolls.[156] Thus, those who want to participate in credit transactions, not taxpayers as a whole, are the ones who bear the costs of discharge. By limiting cause and effect in this way, bankruptcy is economically fair: only those who use credit are required to bear the additional cost of discharge. Furthermore, because bankruptcy terminates collection actions, the debtor is less likely to "loaf" to prevent the accumulation of assets which would be subject to collection by his creditors.[157] Thus, discharge provides an important social benefit by insuring that productivity does not decline.[158]

### C. The Price of Bankruptcy Discharge: Chapters 7 and 13

The policies of bankruptcy discharge are implemented in practice by the filing, administration, discharge, and closing of an individual debtor's case. Countervailing policies are addressed within the bankruptcy framework through the non-dischargeability of certain debts.[159] To illuminate the context of non-dischargeability of a particular debt (e.g., criminal restitution), the following discussion of the mechanics of bankruptcy illustrates how the debtor obtains a discharge, what factors into the bargain between the debtor wishing to obtain a discharge and his creditors, and the legal process that grants the discharge. The individual debtor contemplating bankruptcy has two choices:[160] a Chapter 7 liquidation[161] or

154. Teresa A. Sullivan, et al., *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1087, 1096.

155. Jackson, *supra* note 66, at 1415.

156. *Id.* at 1402 ("If there were no right of discharge, an individual who lost his assets to creditors might rely instead on social welfare programs. . . . [D]ischarge imposes much of the risk of ill-advised credit decisions not on social insurance programs but on creditors.").

157. *See, e.g., id.* at 1420.

158. *Id.* Nevertheless, some commentators have questioned the rehabilitative value of bankruptcy, noting the lack of counseling provided to debtors. In fact, the Commission sought to include counseling as part of the bankruptcy process in its 1973 recommendations. *See* COMMISSION REPORT, *supra* note 10, at 74. There is some evidence that the budgetary constrictions of Chapter XIII under the old Bankruptcy Act may have provided instruction in financial discipline to debtors. Milton J. Morris, Note, *The Wage Earner Plan—A Superior Alternative to Straight Bankruptcy*, 9 UTAH L. REV. 730, 737 (1965).

159. *See generally infra* Part II.D.1 and notes 202-216.

160. Actually, the debtor has three choices because an individual debtor can file Chapter 11 if her debts exceed the limits of Chapter 13. Furthermore, "local legal culture" expressed by attorneys' preferences and the chapter into which they guide their clients may influence the debtor's choice, a choice which may not be in the debtor's best interests. SULLIVAN ET AL., *supra* note 35, at 246-52.

161. 11 U.S.C. §§ 701-766 (1988).

a Chapter 13 plan.[162] The debtors' choice of Chapter 7 or 13 depends on many factors, including: the amount she owes,[163] the nature and extent of her property, and whether she has a regular income stream sufficient to pay creditors under a Chapter 13 plan. In addition, the discharge[164] afforded the debtor under these two chapters differs in certain respects and may influence the debtor's selection of Chapter 7 or 13. Depending on the selection made, the cost of discharge is either future wages (Chapter 13) or non-exempt property (Chapter 7).

*(1) Chapter 7*

In a Chapter 7 case, the debtor surrenders her non-exempt assets[165] in exchange for a discharge of pre-existing debts, regardless of the extent to which creditors are repaid.[166] Upon the filing of the bankruptcy petition, the trustee appointed to administer the debtor's assets obtains legal title to the estate's property.[167] If there are sufficient non-exempt assets, the trustee liquidates those assets and pays creditors pro-rata. If the debtor's non-exempt assets are insufficient to pay creditors, the case is administered as a "no-asset" case, with creditors receiving nothing.[168] A finding that property is exempt means that creditors cannot reach that property to satisfy their claims; the trustee cannot liquidate that property.[169] Under the § 522 exemption provisions, the debtor may either choose state law exemptions or avail herself of the federal provisions.[170] Exempt property generally includes necessaries not exceeding a certain

162. 11 U.S.C. §§ 1301-1330 (1988 & Supp. II 1990).

163. Though this is irrelevant to eligibility for bankruptcy, it becomes important under a Chapter 13 plan, in which the debtor repays some or all of her debts.

164. Discharge refers to the comprehensive discharge of the debtor from pre-petition debts, and is distinct from the "non-dischargeability" issue of a particular debt. In all proceedings certain classes of debts are non-dischargeable; though a debtor can receive a "discharge," at the same time a creditor can receive a determination that her debt is non-dischargeable in the bankruptcy proceedings for the various reasons listed in § 523. *See* 11 U.S.C. § 523 (1988 & Supp. II 1990). This distinction between the general "discharge" and "dischargeability" of a particular debt is not crucial to this Note, since the impetus behind both is the same. *See infra* note 241.

165. 11 U.S.C. § 522(d) (1988).

166. Creditors of a Chapter 7 debtor often receive nothing. Most Chapter 7 cases are "no-asset"; there are negligible non-exempt assets for the trustee to administer and so the case is usually closed without administration of any assets. *See, e.g.,* 11 U.S.C. § 704 (1988) (duties of trustee); BANKR. R. 2015 (same); Schwaber v. Reed (*In re* Reed), 89 B.R. 100, 101 (Bankr. C.D. Cal. 1988) (describing "No Asset Report" filed by trustee where there are no assets worth liquidating for the benefit of creditors).

167. Property of the estate is defined in 11 U.S.C. § 541 (1988 & Supp. II 1990).

168. See *supra* note 166.

169. TREISTER, *supra* note 95, at 299.

170. Exemptions may be claimed under federal statute, 11 U.S.C. § 522(d), or the debtor's domicile state exemption statute. Some states have opted out of federal exemption scheme and the debtor must claim exemptions under the state statute. However, under the federal scheme, 11 U.S.C. § 522(d) provides the debtor may exempt, inter alia, the following property:

value.[171] Thus, Chapter 7 does not completely divest the debtor of all property; the debtor is left with enough so that her fresh start is not hampered by the need to re-equip herself with the necessaries of life.[172]

Because Chapter 7 proceedings leave the debtor with some property, the Bankruptcy Code does not provide relief from all debts. The Chapter 7 discharge excludes certain types of debts, reflecting a policy judgment that certain kinds of debts should be repaid. These include liability for willful and malicious injuries (intentional torts),[173] spousal and child support,[174] credit obtained by false pretenses,[175] educational loans,[176] and governmental fines and penalties.[177]

*(2) Chapter 13*

By contrast, the Chapter 13 debtor keeps her property but must use future income to satisfy creditor claims.[178] The debtor may choose Chapter 13 if she has significant non-exempt assets (which would be sub-

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(1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor . . . uses as a residence . . . .

(2) The debtor's interest, not to exceed $1,200 in value, in one motor vehicle.

(3) The debtor's interest, not to exceed $200 in value in any particular item or $4,000 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments . . . .

. . . .

(6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools, of the trade . . . .

. . . .

(10) The debtor's right to receive—

(A) a social security benefit;

. . . .

(D) alimony, support, or separate maintenance . . . .

11 U.S.C. § 522(d) (1988).

171. 11 U.S.C. § 522(d) (1988).

172. This policy is also embodied in the non-waivability of exemptions. *See* 11 U.S.C. § 522(e) (1988).

173. 11 U.S.C. § 523(a)(6) (1988).

174. 11 U.S.C. § 523(a)(5) (1988).

175. 11 U.S.C. § 523(a)(2) (1988).

176. 11 U.S.C. § 523(a)(8) (1988 & Supp. II 1990).

177. 11 U.S.C. § 523(a)(7) (1988). This section was crucial to the *Kelly* court's finding of non-dischargeability of criminal restitutive obligations. The Court determined that § 523(a)(7) applied though the statute did not specifically state "restitution." It was also unclear whether restitution was "compensation for actual pecuniary loss" because there are two possible interpretations of restitution: punishment and compensation. Kelly v. Robinson, 479 U.S. 36, 50-51 (1986). For the Court's analysis of the restitution dischargeability problem, see *infra* Part V, and for a detailed discussion of restitution, see *infra* Part III. Discharge exceptions are discussed more fully *infra* Part II.D.1.

178. "[T]he purpose of Chapter 13 is to provide the maximum recovery to creditors while at the same time leaving the debtor sufficient money to pay for his or her basic living expenses." *In re* Jones, 55 B.R. 462, 466 (Bankr. D. Minn. 1985). The *Jones* court obviously still believes creditor payment is the only focus of bankruptcy.

ject to administration in a Chapter 7 case) or property secured by liens which would be sold by the bankruptcy trustee in a Chapter 7 liquidation. Chapter 13 is limited to individuals owing less than $100,000 in unsecured debts, and less than $350,000 in secured debts.[179] Although the debtor must have regular income, she can retain her property[180] while creditors are repaid. Repayment of creditiors is made pursuant to the debtor's Chapter 13 plan of repayment, which the debtor proposes after initiating the case.[181] Income beyond normal living expenses is "disposable income"[182] and must be devoted to paying creditors. Creditors must receive, pursuant to the plan, as much as they would under a Chapter 7 liquidation.[183] The repayment period under a Chapter 13 plan is fixed at three years, but with court approval the plan can take up to five years.[184] After proposal of the Chapter 13 plan, the court confirms the debtor's plan,[185] which does not require creditor approval.[186] A confirmed plan binds all creditors to its provisions.[187] The plan's post-con-

179. 11 U.S.C. § 109(e) (1988).

180. The Chapter 13 debtor's property includes that of a Chapter 7 debtor as specified in § 541, but also includes property acquired by the debtor after the commencement of the case: most importantly, the debtor's earnings, which are used to fund the plan. *See* 11 U.S.C. § 1306(a) (1988). In contrast, a Chapter 7 case does not include after-acquired property. *See* 11 U.S.C. § 541 (1988 & Supp. II 1990) (property of the debtor's estate).

181. 11 U.S.C. §§ 1321, 1322(a) (1988).

182. Disposable income is defined as "income which is received by the debtor and which is not reasonably necessary to be expended . . . for the maintenance or support of the debtor." 11 U.S.C. § 1325(b) (1988).

183. 11 U.S.C. § 1325(a)(4) (1988). Initially, Chapter 13 was interpreted to allow "zero payment" plans. *See, e.g.*, Lawrence Tractor Co. v. Gregory (*In re* Gregory), 705 F.2d 1118, 1122 (9th Cir. 1983) (plan that provided for no payment to unsecured creditors comported with § 1328(a) and such debts were discharged). However, many bankruptcy judges viewed this provision as inadequate to protect unsecured creditors, and felt that some debtors were taking advantage of Chapter 13 to obtain its more generous discharge by proposing to pay less than they potentially were able. Chapter 13 plans must now satisfy the "good faith" standard, which considers amount of proposed payments and ability to pay, and the accuracy of financial data reported. The "good faith" standard was established by BAFJA. *See supra* note 101; *infra* note 198; *see also In re* Lattimore, 69 B.R. 622, 626 (Bankr. E.D. Tenn. 1987) (holding that plan that provided for no payment to unsecured claims was "abuse of purpose and spirit of Chapter 13" and thus did not satisfy "good faith" standard); TREISTER, *supra* note 95, at 343; Joseph P. Corish & Michael J. Herbert, *The Debtor's Dilemma: Disposable Income as the Cost of Chapter 13 Discharge in Consumer Bankruptcy*, 47 LA. L. REV. 47, 50 (1986). Further protection of creditors is found in § 1325(b), which allows creditors or the Chapter 13 trustee to object to the proposed payments. The plan will not be confirmed over any objection unless it provides that the objecting creditor will be paid in full or that plan payments expend all of the debtor's "disposable income" for three years. TREISTER, *supra* note 95, at 343.

184. 11 U.S.C. § 1322(c) (1988). The short repayment periods are designed mostly for administrative efficiency. Under Chapter XIII of the Act, no such time limitation was placed on repayment, which resulted in debtors being under court supervision for years.

185. 11 U.S.C. § 1325(a) (1988).

186. *Id.* This approval is subject to exceptions contained in § 1325(b), discussed *supra* note 183.

187. 11 U.S.C. § 1327(a) (1988).

firmation effect on the debtor's property is not clear,[188] though the Code provides that property of the debtor which is vested in the debtor is free and clear of creditor claims.[189]

Chapter 13 is much more generous than Chapter 7 in the discharge granted. Chapter 7 excepts from discharge a broad category of debts listed in § 523, while Chapter 13 only excepts child and spousal support, educational loans,[190] personal injury damages resulting from drunk driving,[191] long-term debts provided for in the plan,[192] and criminal restitution.[193] The Chapter 13 debtor thus receives what is known as the "super discharge."[194] This discharge is granted at the time payments under the plan are completed.[195] If the debtor is unable to complete payments under the plan, she may be entitled to a hardship discharge. This hardship discharge is conditioned upon the court's determination of

188. It is unclear whether bankruptcy protection extends to property acquired after confirmation of the plan. See, for example, Vaska, *supra* note 114, at 682, and cases cited therein: *In re* Root, 61 B.R. 984, 985 (Bankr. D. Colo. 1986) (estate must continue to exist after confirmation because the Chapter 13 trustee must have power to administer it; therefore the debtor's wages up to amount of plan payments are estate property and protected by automatic stay of § 362); Mason v. Williams (*In re* Mason), 45 B.R. 498, 501 (Bankr. D. Or. 1984) (the estate no longer exists after confirmation because property of the estate vests in debtor, unless specified otherwise in plan; therefore, the automatic stay of § 362 does not protect debtor's post-confirmation wages from garnishment), *aff'd* 51 B.R. 548 (Bankr. D. Or. 1985).

189. 11 U.S.C. § 1327(b), (c) (1988).

190. The educational loan non-dischargeability provision of Chapter 7, § 523(a)(8), was made applicable to Chapter 13 cases in 1990. The Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 3007(b), 104 Stat. 1388-28, amended § 1328(a)(2) by adding a reference to § 523(a)(8).

191. Three exceptions are part of the § 523(a) exceptions applicable to Chapter 7 debtors: Spousal and child support, § 523(a)(5), educational loans, § 523(a)(8), and personal injuries resulting from drunk driving, § 523(a)(9). Missing from Chapter 13's exceptions are, for example, fraudulent claims, embezzlement, and willful and malicious injury.

192. 11 U.S.C. § 1328(a)(1) (Supp. II 1990).

193. 11 U.S.C. § 1328(a)(3) (Supp. II 1990). This section is in the Chapter 13 provisions, rather than the Chapter 7 provisions, because *Kelly* found that § 523(a)(7) applied in a Chapter 7 case. Because § 523(a)(7) presumably could not be applicable to a Chapter 13 case, Congress inserted the amendment in the Chapter 13 provisions of § 1328.

194. Furthermore, a Chapter 13 debtor can get another discharge in less than six years if the plan is successful, unlike a Chapter 7 debtor, who is barred from receiving another discharge within six years. 11 U.S.C. § 727(a)(8) (1988). Some debtors thus take advantage of what is known as a Chapter "20": The debtor files Chapter 13 shortly after receiving a Chapter 7 discharge to capture those debts not discharged by Chapter 7. *See, e.g.*, Downey Sav. & Loan Ass'n v. Metz (*In re* Metz), 67 B.R. 462, 465 (9th Cir. 1986) (recognizing that "Chapter 20" debtor obtains advantages of both Chapter 7 and 13 without suffering their disadvantages: debtor obtains "super discharge" of Chapter 13, retains property, but since debtor obtained prior discharge in Chapter 7 of unsecured debts, debtor's Chapter 13 plan may in effect be a zero-payment plan); Helbock v. Strause (*In re* Strause), 97 B.R. 22, 29 (Bankr. S.D. Cal. 1989) (debtor who has received Chapter 7 discharge not precluded from filing Chapter 13 case even though Chapter 7 case is still pending); William C. Whitford, *Has the Time Come to Repeal Chapter 13?*, 65 IND. L. J. 85, 98 (1989).

195. 11 U.S.C. § 1328(a) (Supp. II 1990).

whether the debtor's inability to complete the plan is due to circumstances beyond her control and whether creditors have received a liquidation amount.[196] The hardship discharge, however, is in essence a Chapter 7 discharge, because the Chapter 7 discharge exceptions of § 523 apply.[197]

Chapter 13's broader discharge may be based on moral considerations, because the debtor's efforts to repay out of her future earnings rather than her current and, most likely, limited assets are more laudatory. Lawyers and legislators are concerned that many debtors who are capable of repaying some or all of their debts nevertheless resort to Chapter 7.[198] By granting a broader discharge in Chapter 13, the Bankruptcy Code encourages repayment. Chapter 13 also provides the debtor with an opportunity to salvage her moral worth by repaying creditors.[199] Given the broader discharge of Chapter 13, the discharge exception of criminal restitution under § 1328(a)(3) may be inconsistent with these policies.[200]

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196. Section 1328(b) reads:

> (b) At any time after the confirmation of the plan and after notice and hearing, the court may grant a discharge to a debtor who has not completed payments under the plan only if—
>
> (1) the debtor's faliure to complete such payments is due to circumstances for which the debtor should not justly be held accountable;
>
> (2) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 of this title on such date; and
>
> (3) modification of the plan under section 1329 of this title is not practicable.

11 U.S.C. § 1328(b) (1988).

197. 11 U.S.C. § 1328(c)(2) (1988). At least one commentator suggests this provision reflects a pro-creditor bias. Van Baalen, *supra* note 153, at 494 n.210.

198. Howard, *supra* note 41, at 1082-83. As one court noted, it is "not the design of the Bankruptcy laws to allow the Debtor to lead the life of Riley while his creditors suffer on his behalf." *In re* Bryant, 47 B.R. 21, 26 (Bankr. W.D.N.C. 1984). Criticism of the discharge granted in the consumer chapters prior to the 1984 BAFJA amendments focused on two points. First, access to Chapter 7 was too easy; there were too many debtors who could fund a plan under Chapter 13 but who instead opted for Chapter 7. This resulted in a credit industry drive for a "mandatory" Chapter 13. Whitford, *supra* note 194, at 90. Second, those debtors who had opted for Chapter 13 were not paying as much as they could under their plans. Corish & Herbert, *supra* note 183, at 50. BAFJA addressed these problems by instituting the "substantial abuse" dismissal provisions for Chapter 7 in § 707(b) and the "disposable income" requirement of Chapter 13 plans in § 1325(b)(1)(B). Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, §§ 312, 317, 98 Stat. 333, 355, 356.

199. *But see* Whitford, *supra* note 194, at 95-96 (fact that debtor repays some debts unde Chapter 13 does not necessarily remove moral stigma of bankruptcy).

200. These inconsistencies and a possible solution are discussed more fully *infra* in Part II.D and V, respectively.

## D. Exceptions to Discharge: Chapters 7 and 13

### *(1) Policy Basis for Exceptions to Discharge*

The various exceptions to Chapter 7 discharge[201] are of two basic types, procedural and substantive. Procedural exceptions are based on the debtor's abuse of and failure to comply with the orderly administration of her bankruptcy case, and substantive exceptions are those which do not fit into the category of those debts owed by the "honest" debtor.[202] These limitations are based on the dangers inherent in a too freely available discharge. If bankruptcy discharge had no cost to the debtor, the economic laws of supply and demand would dictate that debtors habitually and frequently resort to bankruptcy.[203] Undue disruptions to the credit market would result, because the cost of credit would rise, making it more difficult to obtain.[204] Thus, giving up either property or future income is not sufficient; further filters on the debtor's conduct are required to preserve the integrity of the system.

The first group of discharge exceptions addresses procedural defects. Exceptions to discharge will result from the debtor's failure to comply with asset scheduling requirements,[205] failure to keep adequate books and records,[206] refusal to obey court orders or to testify,[207] and receipt of a Chapter 7 discharge within the previous six years.[208] This group of

201. This section includes those discharge exceptions that apply to the "hardship" Chapter 13 discharge as well. As noted above in Part II.C.2, the Chapter 13 debtor has only five discharge limitations unless she fails to complete her plan: alimony and child support payments, restitution obligations, long-term payments under the plan, personal injury damages resulting from drunk driving, and educational loans.

202. 11 U.S.C. § 523(a)(2) (1988) (money, property, etc. obtained by false pretenses); *Id.* § 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity); *Id.* § 523(a)(6) (willful or malicious injury by the debtor to another); *Id.* § 523(a)(9) (Supp. II 1990) (death or personal injury resulting from drunk driving).

203. The limits on the availability of discharge, most notably the six-year bar, have the most direct effect of preventing overuse. Nonetheless, non-legal constraints exist, such as the moral stigma still attached to bankruptcy. *See supra* Part II.B. Indeed, studies indicate that only 4% of debtors are repeaters. Girth, *supra* note 142, at 24.

204. Jackson, *supra* note 66, at 1427 ("free access to discharge would be disastrous for a credit-based economy"); *see also supra* Part II.B.

205. 11 U.S.C. § 521 (1988). This section lists the debtor's duties while in bankruptcy proceedings. The debtor must file a list of creditors, assets and liabilities, and generally cooperate with the trustee by surrendering books, records and other information, and appear at the meeting of creditors. *Id.*

206. 11 U.S.C. § 727(a)(3) (1988). This, of course, also has an element of fraud or intent to hinder and delay creditors; this kind of "moral" as opposed to "procedural" misbehavior is discussed as part of the second group of exceptions.

207. 11 U.S.C. § 727(a)(6) (1988). Again, this exception has moral overtones.

208. 11 U.S.C. § 727(a)(9) (1988). This exception is not a blanket prohibition, however, because the debtor may be able to obtain another discharge if, among other things, her unsecured creditors receive 100% of their allowed claims or in the case of Chapter 13 if the plan is proposed in "good faith" or represents the debtor's "best efforts." 11 U.S.C. § 727(a)(9)(A)-(B) (1988). For a discussion of these standards, see *supra* note 183.

exceptions probably traces its roots to the notion of discharge as a concession made to the debtor in return for submitting to the bankruptcy court's jurisdiction to make distributions to creditors.[209] To acheive fairness, bankruptcy should not be available to those who would seek to circumvent its processes. And as a practical matter, smooth administration of the crowded bankruptcy dockets requires that the courts not be burdened with recalcitrant debtors.

The second group of exceptions has substantive moral overtones. Taxes,[210] educational loans,[211] willful and malicious injury,[212] fines and penalties,[213] and alimony and child support[214] fall within this second group. Debts based on filing a false financial statement with a creditor[215] or resulting from debtor conduct that hinders, delays, or defrauds creditors[216] are also barred from discharge. These exceptions are policy-based and are rooted in the notion that relief should only be granted to the "honest" but overburdened debtor, not those seeking to get out of fraudulently obtained debts they are morally obliged to repay.[217]

The moral obligation inherent in this category of exceptions encompasses the duty to pay "involuntary" creditors, such as those whose claims are based on willful or malicious injury and those claiming alimony and child support, because these are not contract claims made at

209. The debtor's participation in the collection proceedings afforded by bankruptcy can be viewed as the price tag for the discharge granted the debtor. Hillman, *supra* note 115, at 120.

210. 11 U.S.C. § 523(a)(1) (1988). Governments' entitlement to priority in payment over other creditors is probably not based on fairness (governments as "deep pockets" are probably the least hurt by non-payment) but rather on the notion of enforcing a civic duty. Some commentators, however, believe taxes should be dischargeable, since their non-dischargeability is an impediment to the debtor's return to economic health. *See* Howard, *supra* note 41, at 1071.

211. 11 U.S.C. § 523(a)(8) (Supp. II 1990). There is an undue hardship exception to the non-dischargeability of educational loans. However, the undue hardship standard has been strictly applied. TREISTER, *supra* note 95, at 325. See *infra* Part II.D.2 for a more detailed discussion of educational loans.

212. 11 U.S.C. § 523(a)(6) (1988) (covering intentional torts).

213. 11 U.S.C. § 523(a)(7) (1988). This has been interpreted to include criminal restitution obligations in a Chapter 7 case. Kelly v. Robinson, 479 U.S. 36, 50-51 (1986). *See* discussion *infra* Part V.

214. 11 U.S.C. § 523(a)(5) (1988). Even religious tithe is disfavored, although not through the method of exception to discharge: In a Chapter 13 case, it is not considered part of the debtor's necessary living expenses, but part of disposable income; thus the debtor must forego tithe in order to confirm the plan. *See generally* Bruce E. Kosub & Susan K. Thompson, Note, *The Religious Debtor's Conviction to Tithe as the Price of a Chapter 13 Discharge*, 66 TEX. L. REV. 873 (1988) (discussing the courts' interpretations of the ability-to-pay test and its possible conflicts with the first amendment).

215. 11 U.S.C. § 523(a)(2) (1988).

216. 11 U.S.C. § 727(a)(2) (1988).

217. *See* Hallinan, *supra* note 29, at 138 ("[I]t is not difficult to suggest a moral basis for the non-dischargeability of fraud and malicious injury claims, given the existence of widely held standards regarding the ethical status of the conduct involved.").

arm's length as are those made with the debtor's consumer creditors. In addition, the non-dischargeability of obligations such as alimony and child support prevents social externalities that result from placing the debtor's dependents on the social welfare rolls. Prohibitions against such socially undesirable conduct as failing to pay alimony or child support in the bankruptcy context may help to deter such conduct.[218] This channeling function can also have more benign, but positive, economic effects because it streamlines the lending process by reducing information costs. Lenders need not worry about the moral character of consumer borrowers because if fraudulently obtained debts are non-dischargeable, lenders are instead free to concentrate on borrowers' financial ability, information which is easily obtained from credit agencies.[219]

While the first group of procedural exceptions is not subject to much debate, the second group of exceptions based on morally culpable conduct (particularly the lack of exceptions applicable to Chapter 13 cases) is hotly contested.[220] Thus, in recent years, Congress has been restricting the scope of the discharge available to both Chapter 7 and 13 debtors. These new limitations reflect a return to the focus of bankruptcy as a debt collection device—debt repayment being morally desirable. The 1984 Amendments to the Bankruptcy Code[221] contained provisions that resulted from the debate over whether Chapter 7 should be available only to those debtors who did not qualify for Chapter 13.[222] Limiting Chapter 7 to those whose future income would be insufficient to fund a Chapter 13 plan reflects the residual emphasis of bankruptcy as a collection device: because Chapter 13 requires debtors to repay some or all of their debts, it should be the morally favored avenue of bankruptcy relief. A Chapter 13 requirement ultimately was not included in the 1984 Amendments, but the standards for Chapter 13 plans were tightened to avoid the problem of the zero-payment plan debtors who were seeking the broader discharge of Chapter 13.[223]

Chapter 7 cases are also now policed by the "substantial abuse" standard: the court may on its own motion dismiss a Chapter 7 case if it is a substantial abuse of the bankruptcy process.[224] The substantial abuse

218. Jackson, supra note 66, at 1441.

219. Howard, *supra* note 41, at 1070.

220. *See e.g.*, Hallinan, *supra* note 29, at 138 ("These fault-based liabilities are not, however, entirely excepted from discharge . . . they remain fully dischargeable in Chapter 13 cases. From the perspective of moral explanations, this difference in treatment is anomalous, since the blameworthiness of the conduct creating the liability is presumably the same in either [Chapter 7 or Chapter 13 cases].").

221. Pub. L. No. 98-353, 98 Stat. 333 (1984); *see supra* notes 101, 198.

222. Hallinan, *supra* note 29, at 150.

223. Chapter 13 plans must conform to the "good faith" and "best efforts" standards discussed *supra* in note 183.

224. 11 U.S.C. § 707(b) (1988). Section 707(b) reads: "the court . . . may dismiss a case filed by an individual debtor under [Chapter 7] whose debts are primarily consumer debts if it

doctrine is tied to the campaign for mandatory Chapter 13 cases, because one of the standards for determining whether Chapter 7 may be employed without constituting substantial abuse is whether the debtor could have filed Chapter 13.[225] Thus, "abuse" under § 707(b), if founded on an ability to repay debts, is based on a moral conviction that debts should be repaid. This conviction seems out of step with the broad discharge policy of bankruptcy, because modern bankruptcy theoretically does not consider ability to repay as a condition of discharge.

The emergence of these policing doctrines in recent years reflects the ebb and flow of bankruptcy's two competing objectives: creditor payment and debtor discharge. After the expansion of discharge by the Code in 1978, and its subsequent manipulation by debtors, Congress sought both to restrict access to Chapter 7 bankruptcy through the substantial abuse doctrine and to curb misuse of Chapter 13 plans with the "good faith standard." These efforts at reaching a compromise between the twin goals of creditor collection and debtor discharge presage Congress' amendment to § 1328(a), although this amendment is more of an absolute, not a mediation of values between discharge and restitution.

*(2) The Educational Loan Example*

The "hardship" exception for debts based on educational loans is a good example of careful balancing of the competing creditor payment and debtor discharge policies of bankruptcy. Although educational loans are excepted from discharge,[226] the hardship exception allows courts to

finds that the granting of relief would be a substantial abuse of the provisions of this chapter." However, § 707(b) also provides that "[t]here shall be a presumption in favor of granting the relief [discharge] requested by the debtor."

225. This is evidenced by the required income and expense statements in Chapter 7 cases. BANKR. R. 1007(b)(1); Hallinan, *supra* note 29, at 150 (The income and expense statement "would appear to have no other use if it were not intended as the basis for a section 707(b) inquiry."). Courts, however, do not agree on the relevance of the debtor's potential ability to fund a plan to a finding of substantial abuse. *See* Zolog v. Kelly (*In re* Kelly), 841 F.2d 908, 914 (9th Cir. 1988) (debtor's ability to pay her debts is the primary criteria for finding of substantial abuse); *In re* Strong, 84 B.R. 541, 545 (Bankr. N.D. Ind. 1988) (most important indicator of substantial abuse is whether debtor has enough disposable income to propose a Chapter 13 plan). *But see In re* Krohn, 87 B.R. 926, 928 (Bankr. N.D. Ohio 1988) (substantial abuse existed even though debtor incapable of proposing Chapter 13 plan), *aff'd*, 886 F.2d 123 (6th Cir. 1989).

226. 11 U.S.C. § 523(a)(8) (Supp. II 1990). The exception for educational loans was based on Congress' fear that widespread discharge of student loans would endanger their continued viability:

> This amendment [§ 523(a)(8)] to the Code was adopted in light of testimony that the bankruptcy rate involving student loans had increased significantly and that in some areas of the country, students were being counseled on filing for bankruptcy to discharge their obligations to repay guaranteed student loans. It was felt by some members of Congress that the amendment was necessary to prevent the rise in the default rate on student loans from jeopardizing the student loan program altogether.

make allowances for debtors' good faith efforts at repayment and to consider their circumstances in deciding whether to grant a discharge of an educational loan.[227] Thus, a discharge may be granted if the debtor meets the "conditions" specified by the section. Unlike the presumption in favor of discharging debts, if the Bankruptcy Code categorizes a debt as non-dischargeable, the burden is on the debtor to demonstrate the condition meriting application of the exception.[228]

Section 523(a)(8) provides that educational loans are non-dischargeable unless the debtor can show "undue" hardship or that the loan first became due seven years prior to the filing of the bankruptcy petition.[229] The second exception, a bright-line test, embodies the policy that aged debts have most likely been partially paid, and that the debtor has not filed bankruptcy merely to escape from student loans.[230] Discharging student loans under the second exception will not impair Congress' attempts to prevent abuses of the bankruptcy process and also harmonizes with the fresh start policy in granting these "honest" debtors relief.

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D'Ettore v. Devry Inst. of Technology (*In re* D'Ettore), 106 B.R. 715, 718 (Bankr. M.D. Fla. 1989) (citing H.R. REP. No. 1232, 94th Cong., 2d Sess., 13-14 (1976)).

227. Educational loans may also be singled out for special treatment because "[u]nlike most commercial loans which are granted only upon a showing of creditworthiness and ability to make repayment . . . student loans . . . are granted only upon a debtor establishing need. . . . [These] loans do not require . . . repayment until the borrower has completed his or her education." State Educ. Assistance Auth. v. Johnson, 43 B.R. 1016, 1021 (E.D. Va. 1984).

228. *See, e.g.*, Cadle Co. v. Webb (*In re* Webb), 132 B.R. 199, 201 (Bankr. M.D. Fla. 1991) (In a complaint to determine non-dischargeability, once existence of the debt has been shown by the creditor, "[t]he burden then shifts to the Debtor to prove 'undue hardship.' ").

229. 11 U.S.C. § 523 (Supp. II 1990) provides that:

> (a) A discharge under . . . this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (8) for an educational . . . loan [made by a governmental unit or non-profit institution], unless—
>
> (A) such loan . . . first became due more than 7 years . . . before the date of the filing of the petition; or
>
> (B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents . . . .

230. Discharging a student loan less than seven years old is designed to curb an "abuse[] of the bankruptcy laws by debtors with large amounts of educational loans, few other debts, and well-paying jobs, who have filed bankruptcy shortly after leaving school and before any loans became due. . . ." H.R. REP. No. 595, 95th Cong., 1st Sess. 133 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6094. "This . . . indicates a Congressional policy of excepting discharge in those inequitable situations where Debtors with superior education and employment skills were intentionally abusing the fresh start policies afforded by the bankruptcy laws." Correll v. Union Nat'l Bank (*In re* Correll), 105 B.R. 302, 304 (Bankr. W.D. Pa. 1989); *see also* State Educ. Assistance Auth. v. Johnson, 43 B.R. 1016, 1021 (Bankr. E.D. Va. 1984) ("It is . . . most questionable when a debtor accepts a student loan and then, prior to its maturity, attempts to extinguish the debt in bankruptcy without ever making an attempt to repay it. It stretches credulity to say that the debtor has made an *honest* effort to pay these debts as required by 11 U.S.C. § 1325(a)(3).") (emphasis added).

The first exception is more equitable and subject to judicial interpretation.[231] "Garden variety"[232] hardship, however, is not enough; courts examine claims of hardship on a case-by-case basis[233] and apply stringent standards.[234] The test varies by circuit, but some factors considered include good faith, policy considerations, and the debtor's current financial condition.[235] These categories overlap, as each qualifies the other. For example, the debtor's financial condition will bear on good faith efforts (a high-income as opposed to a low-income debtor who has made no payments); and the policy considerations reflecting the "fresh start" ideal[236] require an honest debtor (which again will require consideration of payments made in relation to income level). Nonetheless, the tests fashioned by courts indicate a willingness to balance equitable factors on a case-by-case basis, a difficult task. By eschewing a bright-line test, courts are more willing to get involved in the analysis of debtors' conditions. Such an involvement indicates a willingness to preserve the fresh start ideal even if it involves the dedication of more judicial resources.

If educational loans can merit judicial discretion and weighing, why not criminal restitution? The stricter discharge standards for educational

231. *See* Evans v. Higher Educ. Assistance Found. (*In re* Evans), 131 B.R. 372, 374-75 (Bankr. S.D. Ohio 1991).

232. D'Ettore v. Devry Inst. of Technology (*In re* D'Ettore), 106 B.R. 715, 718 (Bankr. M.D. Fla. 1989).

233. *Id.* Some courts have specifically rejected attempts to "inject an 'element of objectivity' into the calculus," refusing to employ bright-line tests such as weighing the debtor's income against federal poverty guidelines, and instead using a "fact-sensitive inquiry into the unique facts and circumstances of each bankruptcy case." Evans v. Higher Educ. Assistance Found. (*In re* Evans), 131 B.R. 372, 376 (Bankr. S.D. Ohio 1991).

234. "The statute refers to *undue* hardship and the mere fact that repayment of an educational loan imposes *a* hardship is insufficient to permit discharge of the loan. . . . '[M]ost or possibly all debtors could make a "garden variety" hardship claim' . . . . As a result, bankruptcy courts have narrowly construed [the exception]." Foreman v. Higher Educ. Assistance Found. (*In re* Foreman), 119 B.R. 584, 587 (Bankr. S.D. Ohio 1990) (quoting *D'Ettore*, 106 B.R. at 718) (emphases in original).

235. *See* Evans v. Higher Educ. Assistance Found. (*In re* Evans), 131 B.R. 372, 375 (Bankr. S.D. Ohio 1991). The *Evans* court followed a three-part test, representative of factors considered by most bankruptcy courts, consisting of: (1) a "mechanical test" involving inquiry into the debtor's current employment and income, educational level, work skills, and family support responsibilities; (2) a "good faith test" whereby the court determines whether the debtor "is making a strenuous effort to maximize her personal income within the practical limitations of her vocational profile"; and (3) a "policy test," which considers whether discharge would further the congressional policy behind § 523(a)(8)(B). *Id.* The policy test considers whether discharge would be an abuse of the bankruptcy process, considering factors similar to those enunciated in the legislative history. H.R. REP. No. 959, 95th Cong., 1st Sess. 133 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6094. *See also* Cadle Co. v. Webb (*In re* Webb), 132 B.R. 199, 201-02 (Bankr. M.D. Fla. 1991); Clinton v. Great Lakes Higher Educ. Corp. (*In re* Clinton), 133 B.R. 96, 97-98 (N.D. Ohio 1991).

236. "As for the policy test, courts have stated repeatedly that the Bankruptcy Code is primarily designed to give the honest debtor a fresh start in life." Evans v. Higher Educ. Assistance Found. (*In re* Evans), 131 B.R. 372, 376 (Bankr. S.D. Ohio 1991).

loans represent a congressional policy to prevent bankruptcy from being used as a stepping-stone for those in a career path who could repay their loans.[237] However, there is the "hardship" exception for those whose financial situation has taken a turn for the worse and merit the benefit of a full discharge. Although criminal restitution obligations represent, at a minimal level, a creditor-type relationship with an involuntary creditor, they also represent the judgment of the state. Thus, while they may not be the same footing morally as educational loans, they present the same type of financial scenario: the debtor's fresh start provided by bankruptcy is impaired. Also, many of the criminal restitution statutes themselves provide for a "discharge" of the obligation—and may provide complete exoneration or substitution of a non-monetary penalty if the offender's inability to pay is not an act of bad faith.[238] If the criminal justice system can award relief, bankruptcy discharge of restitutive obligations in the proper situation would not be anomalous with the purposes of criminal restitution. Finally, certain tort judgments are dischargeable,[239] even though they are also involuntary creditor relationships. Fitting restitution into a similar "hardship" discharge scheme can be consistent with both the aims of restitution and bankruptcy discharge.

The educational loan exception looks more like the kind of balancing done in the modern English system of bankruptcy, which grants few unconditional discharges. Though the fresh start policy disdains the conditional discharge, an examination of the English system, which uses conditional discharges, can shed some light on how to approach potential solutions to the criminal restitution/bankruptcy discharge stalemate.

*(3) Discharge in the Modern English System: Suspended, Limited, and Conditional Discharges*

The American system of bankruptcy theoretically does not condition the entitlement to discharge on ability to pay. Instead, bankruptcy courts use non-economic (moral and procedural) devices to filter out those debtors who, by their conduct, should not be entitled to general discharge or the discharge of a particular debt.[240] In that sense it is "unconditional": it is not conditioned on ability to pay. Discharge is a priori the debtor's entitlement; the presumption in favor of discharge is only taken away where it is shown that the debtor's conduct requires that her debts not be discharged.[241] The English system, by contrast, conditions the availability of discharge on some effort to pay.

237. *See* Correll v. Union Nat'l Bank (*In re* Correll), 105 B.R. 302, 304 (Bankr. W.D. Pa. 1989).

238. *See infra* Part III and notes 298-300.

239. Negligence claims are not excepted from discharge by 11 U.S.C. § 523, which only excepts tort judgments based on "willful or malicious injury." 11 U.S.C. § 523(a)(6) (1988).

240. *See supra* Part II.C.2.

241. Discharge will be granted to a debtor unless some objection is made either to her

The English system uses suspended and conditional discharges to control debtors' potential abuse of the bankruptcy system. A suspended discharge is one in which the court withholds the effectiveness of discharge temporarily in response to some undesirable conduct by the debtor.[242] A conditional discharge is one in which the court conditions the discharge on payment of some portion of the debtor's obligations. The English conditional discharge looks something like a Chapter 13 discharge, because the debtor must pay "such balance or part of any balance of the debts . . . out of the future earnings or after-acquired property of the bankrupt."[243] The English system uses a set of "facts" (debtor misconduct) to determine what sort of discharge should be granted. Some usual "facts" found in English bankruptcy proceedings are: assets equal to less than 50% of liabilities, failure to keep adequate books and records, "hazardous speculation," "unjustifiable extravagance in living . . . gambling, or . . . culpable neglect of his business affairs."[244] While in American bankruptcy courts similar misbehavior (such as failure to keep books and records) can lead to denial of discharge, the English system is less rigid, with the presence of special facts leading to the less harsh sanctions of suspended or conditional discharge.[245]

In England an unconditional discharge is the exception to the rule.[246] The English rules reflect more of an emphasis on creditor collection remedies than does American law.[247] The English debtor does not have an option whether or not to repay her debts, as does a debtor who opts for Chapter 7 liquidation. Further, the failure to pay debts in the English system will result in the denial of discharge, while a Chapter 13 debtor who does not meet her plan payments may be granted a "hardship discharge."[248] Although it has been recommended at various times, the American bankruptcy courts have only adopted the conditional discharge in very limited circumstances,[249] because it is considered too pu-

discharge generally, 11 U.S.C. § 727(c)(1) (1988), or to the dischargeability of a particular debt, 11 U.S.C. § 523(c)(1) (Supp. II 1990). *See also* 11 U.S.C. § 707(b) (1988) (presumption in favor of granting debtor discharge).

242. Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(2) (Eng.), *amended by* Bankruptcy (Amendment) Act, 1926, 16 & 17 Geo. 5, ch. 7, § 1 (Eng.), *amended by* Criminal Law Act, 1967, ch. 58, § 10(2), sched. 3, Pt. III (Eng.), *amended by* Insolvency Act, 1976, ch. 60, §§ 6, 8(9) (Eng.).

243. *Id.*

244. *Id.* at § 26(3).

245. Boshkoff, *supra* note 28, at 85.

246. *Id.* at 87.

247. *Id.* at 77.

248. *See supra* notes 196-197 and accompanying text.

249. See 11 U.S.C. § 523(a)(8) (Supp. II 1990), providing for a limited dischargeability of student loans if hardship circumstances exist. An inquiry into the debtor's ability to pay is required here to determine if such hardship exists. *See supra* Part II.D.2.

nitive and would hamper the debtor's return to full participation in the credit economy.[250]

The English system relies heavily on judicial discretion in determining what kind of discharge to grant the debtor. Because English bankruptcy appellate decisions are rare, and the trial courts do not publish decisions, it is difficult to determine what factors judges consider.[251] However, courts generally look at the debtor's "suitability to recommence trading; whether the creditors have been enabled to recover all that might reasonably be made forthcoming to them through the bankruptcy; and the essential consideration of the proper protection of the public."[252] The courts consider rehabilitative factors in addition to creditor collection success, and some prophylactic effect on excessive future spending is considered desirable.[253]

Given the substantial concern in the United States over debtors who could pay under Chapter 13 but do not, conditional or suspended discharges appear to be good solutions to problems that arise with particular debts. However, considering the current all or nothing approach to most debts, discharge policy seems to do little balancing internally. Certain debts that might be discharged are not because to do so requires that the court consider prohibited factors, such as ability to pay. However, there is evidence in the Bankruptcy Code of a more creative approach to discharge. When considering a Chapter 13 debtor's plan and whether a hardship discharge applies, or in the case of educational loans, the bankruptcy court will consider ability to pay and balance equitable factors, including efforts at repayment. The gatekeeper doctrines of "good faith," "best efforts," and "substantial abuse," which attempt to police the bankruptcy process to prevent abuse by unscrupulous debtors, provide sufficient obstacles to prevent exploitation of discharge. On the other hand, the current use of "conditional discharges"—which place the burden of demonstrating entitlement to discharge on the debtor—shows that some debts merit a closer examination by bankruptcy courts. In the case of a criminal restitutive obligation, such controls might be applied to make the discharge process more flexible.

250. "Punishing debtor dishonesty and incompetence by such disabilities as 'conditional discharge' or 'undischarged status' . . . . is not appropriate. . . . These sanctions have the effect of placing legal restraints on the debtor's renewed participation in the open credit economy. . . . Thus they are also incompatible with the fresh start policy that aims to support the goals of the open credit economy." COMMISSION REPORT, supra note 10, at 83. *See also* S. DOC. No. 65, 72d Cong., 1st Sess. 99 (1933) (proposed suspension provision which drew heavily on English and Canadian misconduct standard).

251. Boshkoff, *supra* note 28, at 91.

252. *Id.* at 90 (quoting I.F. FLETCHER, LAW OF BANKRUPTCY 289-90 (1978)).

253. *Id.* at 93 ("[I]t may . . . be . . . that the mere fact of having undergone the somewhat traumatic experience of bankruptcy is itself a sufficiently sharp lesson to ensure that the individual will be more careful in the future.") (quoting BANKER (LONDON), Aug. 1977, at 139-40).

## III. Criminal Restitution

Restitution to the victims of crimes is now a common fixture in the criminal justice systems of the fifty states.[254] As an alternative to the traditional punishment of incarceration, restitution keeps criminal offenders both usefully employed and out of overcrowded prisons.[255] Restitution represents a compromise between the harsh sanction of imprisonment, in which prisoners are often subject to abuse and overcrowded conditions, and probation, which is often no punishment at all.[256]

Restitution is an ancient penalty[257] that became incorporated into civil law as Anglo-American law was divided into the two familiar branches of civil and criminal law.[258] Restitution in the criminal sphere developed in conjunction with probation,[259] and its use has flourished. Restitution is said to serve the dual purposes of rehabilitating the criminal and compensating the victim,[260] although the former is often stressed as its primary purpose.[261] States vary widely in their implementation of restitution, but some common themes emerge, generally reflecting

254. Thirty states require that restitution be considered in imposing criminal sanctions. They are: Alabama, Arizona, Arkansas, California, Colorado, Delaware, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Missouri, Montana, New Mexico, Nevada, North Carolina, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming. *See* Lisa A. Upson, Note, *Criminal Restitution as a Limited Opportunity*, 13 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 243, 243 n.9 (1987) (citing NATIONAL ORG. FOR VICTIM ASSISTANCE, U.S. DEP'T OF JUSTICE, VICTIM RIGHTS AND SERVICE: A LEGISLATIVE DIRECTORY 15 (1985)).

255. The implementation and definition of restitution varies widely from state to state. This is because restitution has many aspects, including procedures, purposes, offenses for which it is used, and categories of eligible recipients. This Note explores the most common statutes as a backdrop against which to address their dischargeability in bankruptcy. *See generally* Alan T. Harland, *Monetary Remedies for the Victims of Crime: Assessing the Role of the Criminal Courts*, 30 UCLA L. REV. 52 (1982) (assessing the basis for support in theory and in law for the use of restitutive sanctions, and documenting the operational constraints placed upon the use of criminal restitution).

256. Note, *supra* note 3, at 932.

257. *Id.* at 933 n.18 (noting that ancient English, Greek, and Roman law, and the Torah contained provisions for repayment to crime victims).

258. *Id.* at 933-34.

259. Harland, *supra* note 255, at 57. However, restitution can also be imposed in connection with or instead of incarceration. *See* Upson, *supra* note 254, at 245.

260. *See* People v. Walmsley, 168 Cal. App. 3d 636, 639, 214 Cal. Rptr. 170, 171 (1985) ("[r]estitution as a condition of probation is favored by public policy both as a means of doing justice to the victim . . . , and for rehabilitation of the offender.") (citations omitted).

261. Note, *supra* note 3, at 937; *see also* United States v. Carson, 669 F.2d 216, 217 (5th Cir. Unit B 1982) ("In fact, though, while recompense to the victim is a usually laudable consequence of restitution, the focus of any probation regimen is on the offender. The order of probation is 'an authorized mode of mild and ambulatory punishment . . . intended as a reforming discipline.' ") (quoting Koramatsu v. United States, 319 U.S. 432, 435 (1943) (quoting Cooper v. United States, 91 F.2d 195, 199 (5th Cir. 1937))) (omission by court).

choices about the state's purpose in imposing restitution, the defendant's ability to pay, the loss to the victim, the rehabilitative value of restitution, and the type of crime committed. Section A of this part traces the historical origins of restitution and its development as a criminal sentence, and the various policies behind restitution and its current position in the criminal justice system. Section B examines the practical aspects of restitution and how it is implemented by various court systems.

### A. Background

Originally, early justice systems made no procedural distinction between what we now know as "civil" and "criminal" wrongs.[262] Crimes were viewed as a private matter and not an offense against the state, although some crimes were classed as "public wrongs," in which the community interest in seeing the offender punished superseded the individual's private interest in recompense or retribution.[263] Restitution was the punishment used to remedy these private wrongs; the offender was required to reimburse the victim for the damage caused by the offense.[264]

As societies came to rely on an institutional hierarchy for their governance, the public interest in seeing wrongs redressed began to dominate the private interest.[265] When the public interest in redressing criminal acts overtook the private interest, punishment in the form of incarceration took the place of restitutionary payments to the victim.[266] Restitution remained available as a remedy in private, or "civil" wrongs,[267] and took on a more limited role in the criminal justice system.

Restitution's use in the American criminal system traces its origins to the first uses of probationary sentences in the 1800s.[268] Today, restitution is firmly embedded in the criminal justice system, although not without some controversy. Critics of restitution believe that because it compensates the victim, restitution redresses a private, not a public, wrong and thus breaches the separation of the criminal and civil branches of law.[269] Such critics overlook the fact that it is restitution's

262. Harland, *supra* note 255, at 52; *cf.* Richard C. Boldt, *Restitution, Criminal Law, and the Ideology of Individuality*, 77 J. CRIM. L. & CRIMINOLOGY 969, 981 (1986) (Restitutionary theory of justice—the belief that the " 'natural' response to offensive behavior" is repayment to victims—is based on assertions that inter alia, "pre-feudal societies treated all instances of harm as a private matter and made no distinction between criminal and civil remedies"; in fact primitive societies did have "public wrongs.").

263. *Id.* at 986-87.

264. Note, *supra* note 3, at 933.

265. Boldt, *supra* note 262, at 981 (The "substitution of sovereign's interest for private interest of victim . . . [was accompanied] by division of law into civil and criminal spheres."); Note, *supra* note 3, at 932-33.

266. Boldt, *supra* note 262, at 981; Note, *supra* note 3, at 933-34.

267. Note, *supra* note 3, at 933-34.

268. Harland, supra note 255, at 57.

269. However, some noteworthy legal commentators believe the distinction between civil

characteristic as an alternative form of punishment that gives it the civil overtones. Further, its use can be seen as an enhancement to other penal sanctions, because by preventing private retribution (by literally making the offender pay for her crime) it leaves criminal sanctions with the courts and promotes their aims of being the primary redressers of such public wrongs.[270]

In its simplest form, restitution consists of returning stolen property to its rightful owner, usually after it has been used as evidence.[271] This most closely resembles contract law restitution, and is more properly designated "restoration."[272] The most common form of criminal law restitution is payment of the damaged or stolen property's value or compensation for services rendered but unpaid.[273] Some courts distinguish restitution from reparation, the former being the "fruits of the offense" and the latter "an amount the defendant can afford to pay."[274]

Restitution as an alternative to imprisonment accomplishes many of the penal system's goals. Incarceration protects the public from commission of crimes by isolating the offender, deters future criminal acts, and rehabilitates the offender.[275] Restitution in conjunction with probation can accomplish the objectives of deterrence and rehabilitation with the added benefit of compensating the victim. Any form of punishment has some deterrent effect, unless the offender views the benefits of the act committed as greater than the penalty.[276] Rehabilitation is accomplished through the positive psychological contribution that repayment affords the offender. Thus, as an alternative sentence, restitution serves the goals of the penal system without straining its resources.

Restitution's value as a rehabilitative device has several facets. It allows the offender to make amends psychologically, which may contrib-

and criminal law is spurious. Jeremy Bentham maintained "[t]hat no settled line can be drawn between the civil branch and the penal is most manifest." JEREMY BENTHAM, THE LIMITS OF JURISPRUDENCE DEFINED 289-98 (1945). *But cf.* 4 WILLIAM BLACKSTONE, COMMENTARIES *2 (wrongs divided into two types, one private and one public). *See also* Note, *supra* note 3, at 935 (commenting that critics of restitution rely on the distinction between the goals of criminal and civil law). This Note does not intend to focus on whether restitution has a proper place in the criminal justice system, but instead will focus on the role it plays and the important purposes restitution serves.

270. Note, *supra* note 3, at 936-37.

271. *See, e.g.*, FLA. STAT. ANN. § 812.061 (West 1976) (rightful owner of money or motor vehicles may obtain return of same).

272. Harland, *supra* note 255, at 61.

273. *See, e.g.*, N.C. GEN. STAT. § 15A-1343(d) (Supp. 1991).

274. Harland, *supra* note 255, at 63 (citing People v. Lofton, 78 Misc. 2d 202, 356 N.Y.S.2d 791 (Crim. Ct. 1974)). In this Note, "restitution" will refer to any order by the criminal court for the payment of money by the offender for the harm suffered by the victim.

275. Upson, *supra* note 254, at 245.

276. POSNER, *supra* note 5, at 206 (suggesting that criminals are "rational calculators" and measure benefits of criminal activity against foregone opportunities, likelihood of apprehension, and severity of punishment).

ute to her self-esteem and enable her to embrace the values necessary to ensure that she adapts properly to society and does not become a repeat offender.[277] Restitution further counters anti-social behavior by making the offender aware that she has injured another person.[278] By mirroring the societal norms of responsibility and reciprocity, restitution can conform the offender's future behavior to desirable goals.[279]

### B. Implementation

In imposing a restitution order, the sentencing judge considers many factors before deciding to impose restitution and determining the appropriate amount. Courts primarily consider restitution most appropriate for non-violent crimes. Violent criminals need to be isolated from the public, and restitution does not serve this function.[280] Furthermore, prisons have become a limited resource, and in order to put them to their best use, they are reserved for repeat offenders or criminals with a violent propensity.[281] Therefore, restitution is often tied to probation; if the restitutionary payments are not made, the terms of probation are violated.[282]

Courts disagree over allowable amounts of restitution. Generally, restitution is tied to the amount of the victim's loss.[283] Because restitution has a punitive aspect, however, it often may exceed the victim's loss.[284] Further, if there is difficulty in measuring the loss, restitution

277. Jacob, *supra* note 3, at 156-57.

278. Laster, *supra* note 30, at 80. In Huggett v. State, 83 Wis. 2d 790, 266 N.W.2d 403 (1978), the court noted:

> Restitution can aid an offender's rehabilitation by strengthening the individual's sense of responsibility. The probationer may learn to consider more carefully the consequences of his or her actions. One who successfully makes restitution should have a positive sense of having earned a fresh start and will have tangible evidence of his or her capacity to alter old behavior patterns and lead a law-abiding life.

*Id.* at 798, 266 N.W.2d at 407.

279. William P. Jacobson, Note, *Use of Restitution in the Criminal Process:* People v. Miller, 16 UCLA L. REV. 456, 456-57 (1969).

280. Upson, *supra* note 254, at 246.

281. *Id.* at 246-47.

282. *See, e.g.*, ALASKA STAT. § 12.55.051(a) (1990) (default in payment results in incarceration). This Note focuses primarily on restitution as a condition of probation in the context of the bankruptcy discharge; therefore, other uses of restitution are not discussed.

283. FLA. STAT. ANN. § 775.089(1)(a) (West Supp. 1992) provides "the court shall order the defendant to make restitution to the victim for damage or loss caused directly or indirectly by the defendant's offense . . . ." Florida's restitution statute also includes provisions for the payment of medical expenses and lost income. *Id.* § 775.089(2)(a)-(c). The Supreme Court in *Kelly v. Robinson* noted that CONN. GEN. STAT. § 53a-30(a)(9), which required the defendant to "make restitution of the fruits of his offense . . . in an amount he can afford to pay . . . for the loss or damage caused thereby" did not "require imposition of restitution in the amount of the harm caused. Instead, it provides for a flexible remedy tailored to the defendant's situation." 479 U.S. 36, 52-53 (1986).

284. Generally, the amount must be tied to the offense for which the defendant is con-

need not be ruled out as punishment on that basis.[285] Nevertheless, most courts require that the restitution amount ordered bear a "reasonable" relation to the crime committed.[286]

Courts also take into account other factors, such as ability to pay.[287] This can become important in the rehabilitative context, because an offender who is unable to pay an unreasonably high restitution sentence may become discouraged, destitute, and resort to further crime.[288] Some states require the court to consider such factors as the defendant's physical and mental health, age, education, employment, family circumstances, financial condition, and damage to the victim.[289] Courts may also be empowered to adjust the restitution order. In Michigan, the court must withdraw the restitution condition if payment is impossible or

victed. However, some courts have gone beyond this, most notably in the case of People v. Miller, 256 Cal. App. 2d 348, 64 Cal. Rptr. 20 (1967), where the defendant was ordered to pay restitution not only to the victim, but to other customers who suffered losses as a result of his conduct. *Cf.* ILL. REV. STAT. § 1005-5-6(c)(1) (1990) (in case of multiple defendants, victim may not recover in excess of actual damages caused by defendants); MISS. CODE ANN. § 99-37-3(1) (Supp. 1991) (restitution award may not exceed jurisdictional limit of imposing court). *See also* Jacobson, *supra* note 279, at 457-59; Harland, *supra* note 255, at 84 n.196.

285. *See, e.g.,* KY. REV. STAT. ANN. § 533.030 (Baldwin 1990) (in lieu of monetary restitution court may order defendant to make restitution by working for or on behalf of victim).

286. *See, e.g.,* People v. Dominguez, 256 Cal. App. 2d 623, 627, 64 Cal. Rptr. 290, 293 (1967) ("A condition of probation which (1) has no relationship to the crime of which the offender was convicted, (2) relates to conduct which is not in itself criminal, and (3) requires or forbids conduct which is not reasonably related to future criminality does not serve the statutory ends of probation and is invalid."). Some courts allow restitution for pain and suffering. *See e.g.,* State v. Morgan, 8 Wash. App. 189, 190, 504 P.2d 1195, 1196 (1973) (awarding restitution to the victim of an assault pursuant to WASH. REV. CODE ANN. 9.92.060(2)). Restitution payments may be made in installments or as a lump sum payment. *See, e.g.,* ALASKA STAT. § 12.55.045(c) (1990) (restitution may be made within specified time period or in installments); GA. CODE ANN. § 42-8-34.1 (d) (Michie 1991) (restitution may be paid in lump sum or by periodic payments).

287. Harland, *supra* note 255, at 91-94. Harland notes that there are two schools of thought on the relevance of ability to pay to the restitutionary sentence: (1) ability to pay should only be considered when enforcing the obligation, not when it is imposed; and (2) ability to pay is central to determining the amount of restitution to be imposed. *Id.*; *cf.* ALASKA STAT. § 12.55.045(a) (1990) (defendant presumed to have ability to pay restitution).

288. Harland, *supra* note 255, at 92 (27-year restitution term undermined petitioner's sense of responsibility) (citing Huggett v. State, 83 Wis. 2d 790, 266 N.W.2d 403 (1978)). *See* FLA. STAT. ANN. § 775.089(3)(b) (West Supp. 1992) (limiting time over which restitution payments may be made); GA. CODE ANN. § 42-8-34.1 (e) (1991) (limiting probation to four years).

289. *See, e.g.,* N.C. GEN. STAT. § 15A-1343(d) (Supp. 1991) ("[T]he court shall take into consideration the resources of the defendant, including all real and personal property owned by the defendant . . . his ability to earn, his obligation to support dependents . . . ."); TENN. CODE ANN. § 40-35-304(d) (1990) ("[T]he court shall consider the financial resources and future ability of the defendant to pay . . . ."); *cf.* ARIZ. REV. STAT. ANN. § 13-804(c) (Supp. 1991) (court shall not consider defendant's economic circumstances in fixing amount of restitution).

would constitute "undue hardship."[290] Nebraska will not order restitution if the victim was an aider or abettor of the crime, or if the loss to the victim does not exceed ten percent of his or her net financial resources.[291] Alaska considers the potential burden restitution may place on the dependents of the defendant.[292] Courts thus consider the same factors in enforcing restitution obligations that they do in granting hardship discharges. These factors reflect concerns that criminals and debtors not be overburdened and the necessity that the welfare rolls be kept to a minimum.[293]

Restitution must be imposed by the sentencing court; it cannot be entrusted to probation officers.[294] However, the clerk of the court or the probation officer may collect and dispense the restitution payments.[295] Often restitution is administered through a victim's crime fund,[296] though in other cases the offender pays the victim directly.[297] Failure to make the required payments leads to default proceedings. If the defendant shows extreme hardship or an inability to pay, courts may modify the order.[298] However, in the absence of these factors, delinquency will result in imprisonment.[299]

290. People v. LaPine, 63 Mich. App. 554, 558, 234 N.W.2d 700, 702 (1975).

291. NEB. REV. STAT. § 81-1822(1), (5) (1987).

292. ALASKA STAT. § 12.55.045(a)(3) (1990).

293. *See supra* Part II.B; MISS. CODE. ANN. § 99-37-3(a)(c) (Supp. 1991) (court may consider rehabilitative effect of restitution in determining whether to impose).

294. *See, e.g.*, FLA. STAT. ANN. § 775.089(1)(a) (West Supp. 1992) ("[T]he *court* shall order the defendant to make restitution to the victim . . . .") (emphasis added).

295. *See, e.g.*, FLA. STAT. ANN. § 775.089(11)(a), (b) (West Supp. 1992); GA. CODE ANN. § 42-8-34.1(d) (Michie 1991) (payments may be made to clerk of sentencing court or probation officer).

296. *See, e.g.*, N.C. GEN. STAT § 15B-23 (1991) (establishing a "Crime Victims Compensation Fund"). The amounts collected for such funds can be substantial. In 1990, for example, Ventura County, California, collected $1 million from criminals and made payments to 1,958 victims. Some of the funds went for victim compensation, which is not "restitution" in the sense used in this Note. Hugo Marting, *Collections Up for Crime Victim Fund,* L.A. TIMES, Apr. 16, 1991, at B1.

297. *See, e.g.*, MD. ANN. CODE art. 27, § 640(a)(3)(i) (1992). Often, the victim may enforce the restitution award as a civil judgment. *See, e.g.*, ALASKA STAT. § 12:55.051(a); ARIZ. REV. STAT. ANN. § 13-810(c)(3).

298. Equal protection problems may result if inability to pay results in the revocation of probation, because the state cannot convert the fine into a jail sentence based on the defendant's indigency. Williams v. Illinois, 399 U.S. 235, 243 (1970) ("[S]tatute permitting sentence of both imprisonment and fine cannot be parlayed into a longer term of imprisonment than is fixed by statute since to do so would be to accomplish indirectly . . . that which cannot be done directly."); Harland, *supra* note 255, at 112 n.342. However, there is no problem with the prohibition on imprisonment for debt because restitution does not create a debtor/creditor relationship. *Id.* at 114 n.342. Nevertheless, this ignores the practical result of revocation.

299. *See* ALASKA STAT. § 12.55.05(a) (1990); ARIZ. REV. STAT. ANN. § 13-810(B) (Supp. 1991); FLA. STAT. ANN. § 775.089(4) (West 1992). Intentional default, or a reckless disregard of the restitution order showing lack of good faith is usually required. *See* Harland, *supra* note 255 at 112, n.341.

Some courts, however, avoid incarceration by converting the restitution into community service, particularly where the default is based on inability to pay.[300] This makes sense in light of the rehabilitative facet of restitution. The prison environment is not conducive to developing the social skills to be learned through the discipline of repaying one's debt, and may instead cause further breakdown in the offender's mental state such that upon release she will commit further crimes. Thus, in order to further the rehabilitative goals of restitution, courts should avoid imprisoning those who cannot pay their restitutive obligations.

## IV. Federalism: State Criminal Law and Federal Bankruptcy Law

The state aims of criminal rehabilitation and punishment and the federal aims of bankruptcy discharge, although administered in separate spheres, collide when a debtor who owes restitution files for bankruptcy and seeks a discharge of the restitutive obligation. One way conflict is minimized is through the doctrine of forbearance known as "abstention," under which the federal court avoids meddling in state court criminal decisions absent compelling need.[301] The concerns underlying the doctrine of federalism were cited by the Supreme Court in both *Kelly v. Robinson*[302] and *Pennsylvania Department of Public Welfare v. Davenport*.[303] Federalism played a pivotal role in the *Kelly* decision and undoubtedly influenced Congress' amendment of § 1328(a).

The doctrine of federalism is defined as "a proper respect for state functions."[304] In practice, this means that in certain situations federal courts will defer to state courts in matters of importance to the states.[305] The Supreme Court has defined federalism as

> a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the

300. GA. CODE ANN. § 42-8-34.1(b) (1991) (court may consider alternatives such as community service, diversion centers, and "any other alternative to confinement deemed appropriate by the court"); Harland, *supra* note 255, at 118.

301. Younger v. Harris, 401 U.S. 37, 43 (1971). "Abstention" refers to the discretionary decline of federal courts having proper jurisdiction to entertain a controversy in favor of a state forum. Barry Friedman, *A Revisionist Theory of Abstention*, 88 MICH. L. REV. 530, 531 (1989).

302. 479 U.S. 36, 49 (1986) ("States' interest in administering their criminal justice systems free from federal interference is one of the most powerful of the considerations that should influence a court considering equitable types of relief [i.e., bankruptcy courts].").

303. 495 U.S. 552, 564 (1990) (recognizing that discharge of criminal restitutive obligation may hamper flexibility of state criminal judges).

304. *Younger*, 401 U.S. at 44 (describing the notion of "comity"—"perhaps for lack of a better and clearer way to describe it, [it] is referred to by many as 'Our Federalism' ").

305. Michael Wells, *The Role of Comity in the Law of Federal Courts*, 60 N.C. L. REV. 59, 61 (1981). Comity also serves as a basis for deciding choice of law issues, such as between states or between state and federal law. *Id.* at 61 n.5.

> National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways.[306]

The "Younger" doctrine, based on the seminal 1971 case,[307] and cited by the Supreme Court in the *Kelly* and *Davenport* decisions, holds that federal courts should not interfere with pending state criminal proceedings.[308] The rationale behind *Younger*'s use of the federalism doctrine was to avoid disruption of state judicial proceedings. This concern outweighs the individual's interest in a federal forum because federal issues can be heard in a pending state action.[309]

In contrast to the hands-off attitude of abstention is the abrogation of state laws under the doctrine of preemption. Preemption is based on the Supremacy Clause[310] and arises when federal law conflicts with state law. Federal law will preempt state law if Congress has expressly or impliedly preempted any state legislation in the area; Congress occupies the field so as to preclude legislation by the states and to preserve national uniformity; or any state legislation enacted would be disruptive to the federal scheme.[311] Preemption thus serves to reject state laws that "interfere with or are contrary to, the laws of congress."[312]

Federalism and preemption are issues properly raised by the *Kelly* and *Davenport* decisions. Bankruptcy law is exclusively federal and preempts state court jurisdiction and state-law-based collection actions over the property of the debtor while she is in bankruptcy.[313] Federalism, on the other hand, mandates non-interference with state criminal proceedings.[314] This Section explores the Supreme Court's reasons for applying the doctrine of federalism to bankruptcy discharges of restitu-

306. Juidice v. Vail, 430 U.S. 327, 334 (1977) (quoting *Younger*, 401 U.S. at 44). A concept closely related to federalism is "comity." Comity has been defined as the relationship between the state and federal judicial systems; federalism as the relationship between the states as sovereign entities and the federal government. Friedman, *supra* note 301, at 536. Thus, strictly speaking, federal intervention into state court proceedings is governed by "comity"; recognition of state interests in their institutions is federalism. Courts, however, use the terms interchangeably to denote the federal respect for state government or state courts, and the term "federalism" will be cited in this Note to refer to a policy of federal deference to state functions and autonomy.

307. *Younger*, 401 U.S. at 45.

308. *Kelly*, 479 U.S. at 47; *Davenport*, 495 U.S. at 564.

309. Wells, *supra* note 305, at 70.

310. U.S. CONST. art. VI, cl. 2.

311. Pennsylvania v. Nelson, 350 U.S. 497, 502-05 (1956).

312. Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 317 (1981) (quoting Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 211 (1824)).

313. *See, e.g.*, Perez v. Campbell, 402 U.S. 637 (1971).

314. Federalism is not constitutionally mandated, although the Supremacy Clause, which provides that the "Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land" requires that federal law supersedes and is binding on the states. U.S. CONST. art. VI, cl. 2.

tive obligations, and whether bankruptcy law, as exclusively federal, should preempt further enforcement of the criminal restitutive obligation.

### A. The *Younger* Abstention Doctrine

"Our Federalism," the doctrine of abstention defined by the Supreme Court in *Younger v. Harris*,[315] severely limits the injunctive power of federal courts over state court proceedings.[316] *Younger* requires a balancing of state and federal interests to determine whether a federal court should decline to enjoin state judicial proceedings.[317] Although *Younger* was applied to a pending criminal proceeding, the Court has cited important state interests and subsequently extended it to various other circumstances, including civil proceedings.[318] *Kelly* and *Davenport* both reflect the extension of *Younger* to the civil bankruptcy context and explicit identification of important state interests: even though no criminal actions were pending in these cases, the bankruptcy courts as courts of equity were abrogating the sentence of restitution by dishcarging it. Thus bankruptcy discharge was depriving the states of a valued criminal sanction.

315. 401 U.S. 37, 43 (1971).

316. The Anti-Injunction Act, 28 U.S.C. § 2283 (1988), limits the power of federal courts to grant equitable relief. The Bankruptcy Code is excepted from the operation of § 2283 by 11 U.S.C. § 105(a) (1988); hence, only the equitable doctrines of *Younger* are discussed in this Note. *See In re* Davis, 691 F.2d 176, 177 (3d Cir. 1982) (Bankruptcy Code is "expressly authorized exception" to the Anti-Injunction Act.).

317. Critics of the abstention doctrine believe it violates the mandated separation of powers because it requires federal courts to decline to exercise jurisdiction given them by Congress. *See* Martin H. Redish, *Abstention, Separation of Powers, and the Limits of the Judicial Function*, 94 YALE L.J. 71, 112 (1984).

318. Originally applied to a criminal proceeding, *Younger* was actually based on two rationales: 1) that courts of equity should not enjoin a criminal prosecution; and 2) "Our Federalism"—that federal courts should avoid interfering with with ongoing state court criminal proceedings. *See Younger*, 401 U.S. at 44 (federal government in vindicating federal rights must do so in a way that does not interfere with the "legitimate activities of the states"). However, decisions applying *Younger* have emphasized the federalism rationale and focused on the importance of the states' interest in their judicial processes. Hence, *Younger* has been extended to civil cases to require federal court abstention if an important state interest can be identified. *See, e.g.*, Moore v. Sims, 442 U.S. 415, 435 (1979) (*Younger* barred injunctive relief in parental abuse action because of state interest in child protection); Juidice v. Vail, 430 U.S. 327, 338-39 (1977) (*Younger* applies to civil contempt action because of state interest in its contempt proceedings); Huffman v. Pursue, Ltd., 420 U.S. 592, 607 (1975) (*Younger* applies to civil obscenity abatement action because action related to criminal statutes). *But see* Steffel v. Thompson, 415 U.S. 452, 475 (1974) (if no state criminal proceeding pending, federal intervention does not contravene policies of *Younger*).

The most recent case in the civil area is Pennzoil Co. v. Texaco, Inc., 481 U.S. 1 (1987). In Pennzoil, Texaco filed suit in federal court to enjoin the enforcement of Pennzoil's $10 billion judgment against it. The Supreme Court ordered the federal court to abstain. *Id.* at 17.

The Framers of the Constitution believed that state courts were more than adequate to protect federal rights.[319] Thus, the Constitution does not require, though it permits, the creation of the lower federal courts.[320] Following the Civil War, Congress granted the federal courts jurisdiction to hear cases raising issues of federal law.[321] This expanded jurisdiction was in tandem with enactment of civil rights legislation designed to protect the rights of individuals from state interference.[322] Because of this legislation, the new structure of law that emerged in the post-Civil War era—and especially of the Fourteenth Amendment, which was its centerpiece—clearly established the Federal Government as a guarantor of basic federal rights against state power.[323] Federal courts now had a

> vast range of power which had lain dormant in the Constitution since 1789. These courts ceased to be restricted tribunals of fair dealing between citizens of different states and became the *primary* and powerful reliances for vindicating every right given by the Constitution, the laws, and treaties of the United States.[324]

Against this backdrop of expanded federal power, the most enduring national bankruptcy law was enacted in 1898.[325]

The *Younger* doctrine thus represents a departure from the spirit of nationalism which was the impetus behind the 19th century expansion of federal jurisdiction. Younger requires a balancing of federal and state interests, but the balance is weighted in favor of the states.[326] In determining whether abstention is appropriate,[327] federal courts consider

319. "During most of the Nation's first century, Congress relied on the state courts to vindicate essential rights arising under the Constitution and federal laws." Zwickler v. Koota, 389 U.S. 241, 245 (1967).

320. Martin H. Redish, *The Doctrine of* Younger v. Harris*: Deference in Search of a Rationale*, 63 CORNELL L. REV. 463, 466-67 (1978).

321. Act of Mar. 3, 1875, ch. 137, 18 Stat. 470. This is the predecessor to 28 U.S.C. § 1331 (1988).

322. *See* U.S. CONST. amends. XIII-XV; *see, e.g.*, Act of April 9, 1866, ch. 31, 14 Stat. 27; Act of May 31, 1870, ch. 114, 16 Stat. 140; Act of April 20, 1871, ch. 22, 17 Stat. 13; Act of March 1, 1875, Ch. 114, 18 Stat. 335.

323. Mitchum v. Foster, 407 U.S. 225, 239 (1972).

324. Zwickler v. Koota, 389 U.S. 241, 247 (1967) (quoting FELIX FRANKFURTER & JAMES M. LANDIS, THE BUSINESS OF THE SUPREME COURT: A STUDY IN THE FEDERAL JUDICIAL SYSTEM 65 (1928)) (emphasis added by court).

325. Ch. 541, 30 Stat. 544 (1898), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682. After repeal of the 1867 Act, "it was apparent that if the defects of the 1867 Act could be ironed out, a national bankruptcy law became every day more necessary with the expansion of American commercial activity." Wiecek, *supra* note 75, at 357.

326. George D. Brown, *When Federalism and Separation of Powers Collide—Rethinking Younger Abstention*, 59 GEO. WASH. L. REV. 114, 120 (1990) ("[A] weakness [of *Younger*] is that though *Younger* appears to represent a kind of balancing of federal and state interests, the nature and weight of the federal interest is not adequately discussed [by the court].").

327. *Younger* itself provides for exceptions, stating that in "extraordinary circumstances"

whether exercise of jurisdiction would: (1) slight state courts by questioning their competence or willingness to enforce federal constitutional rights; (2) interfere with the orderly functioning of state judicial processes; (3) interfere with substantive state legislation and policies; or (4) intrude on the discretion of state executive officials and state prosecutors.[328]

Bankruptcy discharge of criminal restitution raises the federalism questions of whether bankruptcy discharge interferes with state criminal justice systems and whether it undermines the legislative policies behind restitution statutes.[329] Bankruptcy interferes with state criminal justice systems because discharging restitutive obligations subverts the effectiveness of criminal sentences. The Court in *Kelly* identified some other potential problems that discharge of restitution would cause. First, requiring state probation departments to appear in bankruptcy court or bear the burden of objecting to discharge would be onerous and costly.[330] Second, the *Kelly* Court believed that state officials would now have to defend their criminal sanctions before federal bankruptcy judges.[331] Third, the expectation that restitutive obligations might be discharged would "hamper the flexibility of state criminal judges in choosing the combination of imprisonment, fines, and restitution most likely to further the rehabilitative and deterrent goals of state criminal justice systems."[332] However, these concerns, while valid, are not insurmountable obstacles preventing the discharge of restitution under certain conditions, as will be explored in Part VI.

### B. Preemption

The Preemption Doctrine mandates that federal law will supplant state law if state legislation and federal legislation conflict, or if Congress prohibits analogous state legislation.[333] Based on the Supremacy Clause of the Constitution,[334] a finding of preemption does not require actual conflict between state and federal law. Rather, in the absence of express preemption, the Court looks at whether Congress has so occupied the

federal courts may enjoin state court proceedings. 401 U.S. at 53-54. These exceptions reflect fact situations where the presumption that state laws are an effective forum to vindicate federal rights has been overcome: bad faith prosecutions, patently unconstitutional laws, or unavailability of an adequate state forum. *See* ERWIN CHEMERINSKY, FEDERAL JURISDICTION 651-55 (1989).

328. *See, e.g.*, Redish, *supra* note 320, at 465-66.

329. Because the state courts cannot pass bankruptcy legislation, the question of whether state courts are unwilling or incompetent does not arise; nor does bankruptcy discharge intrude on executive action.

330. *Kelly*, 479 U.S. at 48.

331. *Id.*

332. *Id.* at 48-49.

333. JOHN E. NOWAK ET. AL., CONSTITUTIONAL LAW § 9.1 (4th ed. 1991).

334. U.S. CONST. art. VI, cl.2.

field as to preclude state legislation on the same subject, or whether the state legislation impermissibly interferes with the effectuation of the interests represented by the federal law.[335] The leading case of bankruptcy preemption is *Perez v. Campbell*,[336] in which an Arizona motor vehicle statute allowed a judgment creditor to commence proceedings with the state licensing board to withhold the debtor's driving privileges until the debt was paid.[337] Although the bankruptcy court had discharged the judgment, the creditor subsequently commenced proceedings which resulted in the debtor's license being suspended.[338] The Supreme Court found that this statute directly conflicted with the Bankruptcy Act's aims, and that it could not constitutionally withstand the Supremacy Clause because it frustrated the goals of bankruptcy discharge.[339]

Unlike abstention, preemption does not require an analysis of the legitimacy or importance of the state interest.[340] Although abstention mandates "sensitivity" to the interests of the states,[341] preemption requires a proper respect for federal law. "The relative importance to the State of its own law is not material when there is a conflict with a valid

335. *See, e.g.*, Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947). When Congress legislates in a field traditionally occupied by the states, the presumption that states' police powers are not superseded is overcome by demonstrating that "Congress left no room for the states to supplement" federal regulation; the federal interest predominates such that state enforcement on the same subject is precluded; state and federal policy may be inconsistent; or state and federal regulations collide. *Id. See also* Pennsylvania v. Nelson, 350 U.S. 497, 502-05 (1956). The *Nelson* Court noted that

> [w]here . . . Congress has not stated specifically whether a federal statute has occupied a field in which States are otherwise free to legislate, different criteria have provided touchstones for decision. Thus, "this Court, in considering the validity of state laws in light of . . . federal laws touching on the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconciliability; inconsistency; violation; curtailment; and interference. But none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula."

*Id.* at 501-02 (footnote omitted) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)) (second omission by court).

336. 402 U.S. 637 (1971). Bankruptcy Code § 362(a) also permits bankruptcy courts to enjoin pending state-law collection actions unless and until relief from the stay is granted under § 362(d). 11 U.S.C. § 362(a), (d) (1988).

337. 402 U.S. at 641-42.

338. *Id.* at 641.

339. *Id.* at 656.

340. Jones v. Rath Packing Co., 430 U.S. 519, 525-26 (1977). "[W]hen Congress 'has unmistakably . . . ordained'. . . that its enactments alone are to regulate a part of commerce, state laws . . . must fall. This result is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." *Id.* at 525 (quoting Florida Lime & Avocado Growers v. Paul, 373 U.S. 132, 142 (1963)).

341. Younger v. Harris, 401 U.S. 41, 44 (1971).

federal law, for the Framers of our Constitution provided that the federal law must prevail."[342]

The Bankruptcy Code illustrates preemption of state insolvency laws. The fractional nature of state insolvency laws in the nineteenth century led to the need for a uniform, federal bankruptcy law to preserve the free flow of commerce between the states.[343] Congress has plenary and exclusive power over bankruptcies, and may enact bankruptcy laws that curtail state court jurisdiction over the debtor's property.[344] The bankruptcy courts created by Congress have a broad grant of jurisdictional power to hear and decide claims and dispose of the debtor's property.[345] As a result, states may not enact legislation that interferes with federal bankruptcy laws by requiring debtors to elect between relief in the bankruptcy court and submission to the jurisdiction of state insolvency laws.[346] The *Kelly* Court's decision to except criminal restitution from discharge, therefore, was not mandated by anything other than the equitable principles of *Younger*.

Thus, prior to Congress' amendment of § 1328(a), bankruptcy courts were empowered to discharge criminal restitutive obligations, as the Court's dischargeability decision in *Davenport* demonstrates. The *Davenport* Court stated "the concerns animating *Younger* cannot justify rewriting the Code to avoid federal intrusion."[347] Nevertheless, the Court in *Davenport* was mindful of the *Younger* problem, stating: "Nor do we conclude lightly that Congress intended to interfere with States' administration of their criminal justice systems."[348] Ultimately, however, the Court held restitutive obligations dischargeable, because "[w]e will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[349] This was a clear invitation to Congress to act.

Congress accepted the invitation, ignoring the preemption issue. Evidently, Congress was more concerned with state interests and believed amending § 1328(a) would not disrupt federal law. However, non-

342. Ridgway v. Ridgway, 454 U.S. 46, 54-55 (1981) (quoting Free v. Bland, 369 U.S. 663, 666 (1962)).

343. *See supra* Part II.A.

344. Kalb v. Feuerstein, 308 U.S. 433, 438-39 (1940) (Constitution grants Congress exclusive power to regulate bankruptcy and this power encompasses ability to curtail state court jurisdiction over person and property of debtor); *see supra* notes 86-87 and accompanying text. Bankruptcy courts have "exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of [the] case." 28 U.S.C. § 1471 (1988).

345. *See supra* Part II.A.

346. International Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929). This is different than the choice the debtor may have between exempting her property under state law or federal law. *See supra* Part II.B.

347. *Davenport*, 495 U.S. at 564.

348. *Id.*

349. *Id.*

dischargeability of restitution denies the debtor the complete "fresh start" embodied in the bankruptcy ideal and disrupts the aims of bankruptcy law. Application of the preemption doctrine to the discharge of criminal restitutive obligations reveals that if the purposes and policies of the Bankruptcy Code are frustrated by the non-dischargeability of such debts, then federal bankruptcy law should preempt state law and such obligations should be dischargeable.[350]

Instead of indicating an attempt to mediate between federal and state interests, Congress' amendment to § 1328(a) shows that Congress felt state interests in criminal restitution were supreme. Although Congress focused on state interests, the question of whether to discharge criminal restitutive obligations in bankruptcy implicates the doctrines of both abstention and preemption. Yet there appears to be an inherent lack of compatibility between the two doctrines; while the preemption analysis places federal interests first, abstention mandates that state interests outweigh the federal. Thus, abstention and preemption represent completely oppositional forces, one of which ultimately has to give way. Both doctrines should be considered in fashioning discharge exceptions, however, because the policies behind federal bankruptcy law are equally important as the state interest in criminal punishment and rehabilitation.

## V. Congress' Amendment to 11 U.S.C. § 1328

In *Kelly v. Robinson,* the Supreme Court held that criminal restitutive obligations were not dischargeable in a Chapter 7 bankruptcy case.[351] The debtor in *Kelly* had pleaded guilty to larceny and was sentenced to a prison term. The judge placed her on probation and ordered that she make restitution to the State of Connecticut Office of Adult Probation in the amount of one hundred dollars per month for the five-year term of her probation.[352] Robinson filed for bankruptcy shortly thereafter and listed the restitutive obligation as a debt. The Probation Department failed to file a timely proof of claim, and its claim was thus disallowed.[353] Robinson was subsequently granted a discharge under § 727.[354] When the Probation Department sought to enforce the obligation, Robinson filed a declaratory relief action in the Bankruptcy Court seeking to establish that the restitutive obligation had been discharged in

350. *See* Perez v. Campbell, 402 U.S. 637, 649 (1971) ("As early as *Gibbons v. Ogden,* Chief Justice Marshall stated the governing principle—that 'acts of the State Legislatures . . . [which] *interfere with,* or are contrary to the laws of Congress, made in pursuance of the constitution,' are invalid under the Supremacy Clause." (quoting Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 211 (1824)) (emphasis added by court) (alteration by court).

351. 479 U.S. 36, 54-55 (1986).

352. *Id.* at 38-39.

353. BANKR. R. 3002(a) (an unsecured creditor must file a proof of claim for the claim to be allowed).

354. *Id.* at 39. See *supra* Part II.C.1 for an explanation of the Chapter 7 discharge.

her bankruptcy and enjoining further enforcement by the Probation Department.[355] The bankruptcy court determined that Robinson's discharge had not affected her restitutive obligations. The district court affirmed, but the Second Circuit reversed the bankruptcy court's order.[356]

The Supreme Court reversed the appellate court's decision, relying on bankruptcy courts' interpretation of criminal penalties as non-dischargeable debts under the Bankruptcy Code. Mindful of bankruptcy courts' deference to state criminal actions and the common law interpretations of the Bankruptcy Code that fines and penalties were not affected by discharge, the Court concluded that Congress could not have intended criminal penalties to be dischargeable as "debts" as defined in § 101(4).[357] Nevertheless, the Court refused to address the question of whether criminal restitution actually could be considered a debt under § 101(4). Instead, the Court held that § 523(a)(7) precluded the discharge of Robinson's restitutive obligations, even though § 523(a)(7) only addressed itself to "fine[s], penalt[ies], or forfeiture[s]. . . not compensation for actual pecuniary loss."[358] The Court found that even though restitution, unlike a criminal fine, was compensation for pecuniary loss, the criminal justice system nevertheless operated for the benefit of society as a whole and not the victim. Citing *Younger v. Harris*,[359] the Court expressed fears that ignoring federalism problems would require state criminal courts to come into bankruptcy court, and disrupt the administration of state criminal justice systems.[360]

In *Pennsylvania Department of Public Welfare v. Davenport*,[361] the Supreme Court held that criminal restitutive obligations constituted a debt under the Bankruptcy Code,[362] and the exception to discharge of *Kelly* did not apply in the Chapter 13 context.[363] The debtors in *Davenport* had pleaded guilty to welfare fraud and were sentenced to one year probation, with the condition that they make monthly restitutive payments to the probation department.[364] Shortly thereafter, the debtors filed a petition under Chapter 13 and listed the restitutive obligation as a

355. 479 U.S. at 40.

356. *Id.* at 42.

357. *Id.* at 44-47.

358. 11 U.S.C. § 523(a)(7) (1988).

359. 401 U.S. 37 (1971).

360. 479 U.S. at 47-49.

361. 495 U.S. 552 (1990).

362. 11 U.S.C. § 101(12) (Supp. II 1990) defines a "debt" as "liability on a claim"; its mirror image is § 101(5)(A) (Supp. II 1990), which defines a "claim" as "right to payment."

363. 495 U.S. at 555. Justice Marshall, who wrote the opinion in *Davenport*, had dissented to the decision in *Kelly* and prophesied a similar challenge to the non-dischargeability of restitution in a Chapter 13 context. Kelly v. Robinson, 479 U.S. at 59, n.6 (Marshall, J., dissenting).

364. 495 U.S. at 556.

debt on their schedules. When the Davenports failed to make further payments, the probation department instituted proceedings for violation of the their probation. The debtors sought to have the probation department retract the violation charges; when the department refused to do so, the debtors commenced a declaratory relief action seeking discharge of the restitutive obligation and an injunction prohibiting its further enforcement.[365] The debtors filed and confirmed their Chapter 13 plan, but the probation department did not file a proof of claim. When the bankruptcy court discharged the criminal restitutive obligation, the probation department appealed and was granted a reversal by the district court. The Third Circuit reversed, finding that Chapter 13 clearly mandated that restitutive obligations were debts under the Bankruptcy Code and hence dischargeable.[366]

The *Davenport* Court explicitly focused on whether restitution constituted a debt under the Bankruptcy Code, which the *Kelly* Court had failed to do. The Court found that even though "the Probation Department's enforcement mechanism is criminal rather than civil, [it] does not alter the restitutive order's character as a 'right of payment.' "[367] The Court based its analysis on a comparison between the discharge provisions of Chapters 7 and 13, noting that the broader discharge provisions of Chapter 13 reflected Congress' belief that it was better for debtors to pay off their debts.[368] To construe debt narrowly, the Court reasoned, "would be to override the balance Congress struck in crafting the appropriate discharge exceptions for Chapter 7 and Chapter 13 debtors."[369] Unlike the *Kelly* Court, however, the *Davenport* Court brushed aside the federalism dilemma, stating that "the concerns animating *Younger* cannot justify rewriting the Code to avoid federal intrusion."[370]

The *Davenport* decision generated a flurry of commentary, most of it expressing dissatisfaction.[371] Much of the debate centered on whether restitution should be considered a debt, because bankruptcy courts prior to both the *Kelly* and *Davenport* decisions had focused exclusively on whether it could fit within the Code's definition of a debt; bankruptcy courts have either taken the approach that restitution was a debt, and

365. *Id.*

366. *Id.* at 557.

367. *Id.* at 557.

368. *Id.* at 563. *See supra* Part II.C.2. The broader discharge of Chapter 13 is a "reward" for the effort made to pay off creditors.

369. 495 U.S. at 563.

370. *Id.* at 564.

371. *See e.g.*, Katherine A. Francis, Note, *Dischargeability of Criminal Restitution Obligations Under Chapter 13 of the Bankruptcy Code:* Pennsylvania Department of Public Welfare v. Davenport, 59 U. CIN. L. REV. 1349 (1991); Michael J. Donovan, *Criminal Restitution and Bankruptcy Code Discharge—Another Case for Defining the Scope of Federal Bankruptcy Law*, 65 NOTRE DAME L. REV. 107 (1989).

thus dischargeable,[372] or that it could not be equated with a debt because no one was entitled to payment, and hence was non-dischargeable.[373] In November 1990, Congress clarified its intent by amending the Chapter 13 discharge provisions to except "restitution included in a sentence on the debtor's conviction of a crime."[374]

The unique nature of restitution as a quasi-debt under the Bankruptcy Code, however, may be better addressed by mediating between the simple classification of restitution as presumptively dischargeable or unequivocally non-dischargeable. When restitutive payments are not made, the offender violates her probation.[375] A probation violation can, though need not, result in incarceration. Incarceration contravenes both the "fresh start" envisioned by the Bankruptcy Code and the potentially rehabilitative effects of restitution. Congress' approach to the problem is absolute and simplistic; it ignores the policy considerations underlying restitution and the Bankruptcy Code in favor of a morally and politically expedient solution. Further, it fails to mediate between the policies of *Younger* and the preemeptive effect of bankruptcy law.

## VI. Proposal

Section 1328(a)(3), the Chapter 13 provision mandating the non-dischargeability of criminal restitution, could be rewritten to include language equivalent to the conditional discharge present in the student loan

372. *E.g.*, Multnomah County v. Price (*In re* Price), 920 F.2d 562, 562 (9th Cir. 1990) (discharging restitutive obligation in Chapter 13 case without discussion, following holding of *Davenport*); Cullens v. District Court (*In re* Cullens), 77 B.R. 825, 828 (Bankr. D. Colo. 1987) (holding restitutive obligation dischargeable in Chapter 13 case because § 523(a)(7), which was applicable only to Chapter 7 cases, indicated congressional intent to confine non-dischargeability of restitutive obligation to Chapter 7 cases); *In re* Vohs, 58 B.R. 323, 326 (Bankr. D. Mont. 1986) (holding restitutive obligation dischargeable in Chapter 13 case where state's main goal in imposing restitution is to compensate victim).

373. *E.g.*, United States v. O'Connell (*In re* O'Connell), 80 B.R. 475, 476 (Bankr. E.D. Mo. 1987) (restitution imposed to further penal and rehabilitative goals, not as compensation; therefore, not a debt dischargeable in Chapter 7 proceeding); Pennsylvania Dep't of Pub. Welfare v. Oslager (*In re* Oslager), 46 B.R. 58, 61-62 (Bankr. M.D. Pa. 1985) (restitutive obligation not dischargeable under Chapter 7 because of federalism concerns and fact that restitution is a criminal sanction, not a debt); Black Hawk County v. Vik (*In re* Vik), 45 B.R. 64, 67, 69 (Bankr. N.D. Iowa 1984) (nature of restitution such that its central focus is not payment to victim, therefore not a debt dischargeable in Chapter 7 proceeding); Pellegrino v. Division of Crim. Justice (*In re* Pellegrino), 42 B.R. 129, 134 (Bankr. D. Conn. 1984) (although "debt" as defined in Bankruptcy Code does not explicitly include restitution, federalism and congressional policy require non-dischargeability in chapter 7 case); *In re* Button, 8 B.R. 692, 694 (W.D.N.Y. 1981) (restitution imposed as criminal punishment not dischargeable in Chapter 7 proceeding). *See also* Federal Deposit Ins. Corp. v. Wright (*In re* Wright), 87 B.R. 1011, 1016 (Bankr. D.S.D. 1988) (*Kelly v. Robinson* applies to restitution imposed under federal law).

374. 11 U.S.C. § 1328(a)(3) (Supp. II 1990).

375. *See supra* Part III.B.

provisions of § 523(a)(8)[376] and the hardship discharge provisions of § 1328.[377] A conditional discharge approach shifts the normal presumption in favor of granting relief to the debtor. Instead, the debtor must demonstrate that the particular debt merits discharge by identifying those circumstances which characterize her as an "honest" debtor or one who has made "good faith" efforts. In considering whether to grant a discharge of the restitutive obligation, the bankruptcy court should weigh the debtor's circumstances and consider prior payments under the plan, ability to make further payments under the plan, and whether the debtor has included the restitutive obligation in the plan or made any prior payments on it. Consideration of these factors will reveal whether the debtor warrants a discharge of the restitutive obligation because discharging the obligation will foster the policies of bankruptcy without harming the goals of criminal restitution, and will prevent corruption of the bankruptcy process by those debtors not deserving discharge of the restitutive obligation.

The policy differences reflected in the different discharge provisions applicable to Chapter 7 and 13 bankruptcy cases support the use of a conditional discharge for criminal restitutive obligations in Chapter 13 cases. The Chapter 7 debtor who does not make repayment to creditors under a plan, but instead offers his non-exempt assets for liquidation, does not merit the same inquiry into hardship, good faith, and best efforts that are made when determining whether to grant a "hardship discharge" under Chapter 13. The Supreme Court in *Davenport* recognized that the broader discharge given Chapter 13 debtors represented Congress' recognition and reward of the debtor's repayment efforts. Based on this, the *Davenport* court discharged the criminal restitutive obligation. However, a presumption of dischargeability of criminal restitution does not accommodate the states' interest in their criminal processes, as Congress recognized when amending § 1328(a). Yet a bright-line dischargeability rule does not accommodate the debtor's interest in rehabilitation, particularly under a Chapter 13 repayment plan. The conditional approach synthesizes the concerns of both extremes by allowing a discharge if the debtor's circumstances merit it, but barring discharge in the absence of such circumstances.

The Bankruptcy Code already contains several policing provisions—conditional approaches to discharge—which reflect concerns that the bankruptcy process not be abused. The "substantial abuse" doctrine used to weed out unmeritorious Chapter 7 cases[378] and the "good faith" and "best efforts" tests used to monitor Chapter 13 plans[379] are exam-

376. *See supra* note 229 and accompanying text.

377. *See supra* note 196 and accompanying text.

378. *See supra* notes 224-225 and accompanying text.

379. *See supra* notes 183, 223.

ples, as well as the various discharge exceptions in §§ 523 and 1328[380] that contain some conditional or limiting language, including the educational loan provisions.[381] These provisions, which require the court to consider more equitable factors, are in tune with the bankruptcy policy of granting relief to "honest" debtors, but at the same time ensure that the debtor who does not make good faith efforts under their Chapter 13 plan, refuses to cooperate with the bankruptcy process, or has incurred debts that policy dictates must be paid, does not obtain a discharge. The somewhat less honest debtor with a criminal record who owes restitution need not be denied the full fresh start afforded by bankruptcy because of past criminal conduct. Although the presence of such past criminal conduct requires that the presumption in favor of discharge be abandoned, resort to an absolute non-dischargeability rule is not necessary; instead, a conditional approach can be used. This conditional approach to the discharge of criminal restitution would conform to the spirit of the Code's other policing provisions.

Restitution, however, is distinguishable from educational loans and other dischargeable debts: restitution is not a purely civil obligation, but also a criminal sanction. While bankruptcy rehabilitates by discharging debts, criminal law rehabilitates by imposing a monetary obligation, restitution. Discharge of restitution on the surface would appear to be contrary to the rehabilitative goals of state criminal laws. However, bankruptcy discharge imposes its cost on the debtor in two ways: First, the debtor has already paid, through interest charges, for the benefits of discharge, and second, the debtor will forfeit property or income in the administration of her bankruptcy estate. Although the debtor who owes criminal restitution has not paid for the costs of discharge in the form of pre-bankruptcy interest, in a Chapter 13 case the debtor will pay the debt with future income. Thus, even under a conditional discharge approach, the debtor cannot escape "paying" for her crime.

Specifically, section 1328(a)(3) could be modelled after the educational loan provisions of § 523(a)(8), for example. Applying a time limitation like that of § 523(a)(8)(A) complements the restitution statutes' prohibition on imposing long-term obligations or the continued enforcement of aged obligations. Crafting an "undue hardship" exception like that of § 523(a)(8)(B) conforms to the hardship exceptions in many restitution statutes that substitute other forms of duties, such as community service, when the offender cannot in good faith continue to make payments. This conditional approach would not upset the rehabilitative goals of restitution. If the debtor has already made some payments and is currently in a situation where further payment has become impossible, granting discharge of the obligation will preserve the aims of both bank-

380. *See supra* notes 205-216, 190-197 and accompanying text.

381. *See supra* notes 226-236 and accompanying text.

ruptcy and restitution. Because the debtor will risk incarceration if restitution is not paid, the potentially rehabilitative effects of restitution and bankruptcy through retained liberty and renewed economic participation will be lost.[382]

Changing § 1328(a)(3) to reflect a conditional approach would preserve supremacy of bankruptcy laws on a national level. This would not offend "Our Federalism" because bankruptcy courts will consider factors of importance to the states in determining whether discharge should be granted or not. These factors include the same factors the criminal court considered in deciding whether to impose the restitution sentence in the first place, such as the nature of the crime, damage to the victim, and ability to pay. State criminal courts will not be disinclined to impose restitution as a punishment because it will not be discharged by those debtors who do not deserve the benefits of discharge. More specifically, as the *Kelly* Court noted, the potential dischargeability of restitution might deter criminal courts from imposing restitution and burden criminal justice systems with the filing of objections to the dischargeability of such an obligation. This concern reflects the deference to state interests behind "Our Federalism." These burdens and potential interference with state interests can be addressed on two levels. First, the burden could be placed on the debtor to establish the "hardship" and good faith efforts meriting the discharge, as in section 523(a)(8). Allowing the trustee to object to the dischargeability of restitution could lessen the state's procedural burden. The inquiry of "hardship" could be focused on the state's interest in preserving the obligation by substituting community service or other duties on the part of the debtor to further the state's rehabilitative and punitive goals. Second, accommodation and recognition of state interests in this manner will not subvert the principles of "Our Federalism"; rather, preserving some chance of discharge for certain meritorious debtors will retain the supremacy of bankruptcy laws on the federal level.

A conditional approach would prevent the bankruptcy courts from becoming a haven for criminals. In order to preserve the rehabilitative effects of criminal restitution, the discharge must be more costly—obstacles to discharge must be left in place. This can be achieved through a conditional approach rather than the absolute approach adopted by Congress. With a conditional approach, avenues to discharge can be left open through the use of hardship exceptions. Under these exceptions bankruptcy courts can also examine the possibility of state-level substitutes such as community service and thereby ensure that the rehabilita-

382. Like bankruptcy, restitution also provides a "fresh start" of its own. *See* Huggett v. State, 83 Wis. 2d 790, 798, 266 N.W.2d 403, 407 (1978) ("One who successfully makes restitution should have a positive sense of having earned a fresh start and will have tangible evidence of his or her capacity to alter old behavior patterns . . . .").

tive goals of criminal restitution are still served. In this way, Congress could prevent debtors who owe criminal restitution from using the bankruptcy laws as "a shield to protect [themselves] from punishment for [their] crime."[383]

## VII. Conclusion

Current bankruptcy law represents an evolutionary step away from debtor's prisons as the fresh start policy removes the stigma of insolvency. As a practical matter, courts cannot avoid the collision of bankruptcy laws and state court criminal penalties. Thus, we should seek to accommodate both with minimal disruptions, mindful of the Supreme Court's federalism concerns as expressed in *Younger* and the purpose of bankruptcy discharge.

The Supreme Court correctly interpreted the application of civil penalties in the criminal context as a debt, and consistent with the Bankruptcy Code discharged such obligation. The inquiry as demonstrated above does not end there. In order to avoid a result after bankruptcy at the state court level that is inconsistent with the fresh start philosophy of bankruptcy and the purposes for which restitution is used, use of the Bankruptcy Code in a more flexible fashion is desirable.

Discharge of criminal restitution need not be inconsistent with either the goals of state criminal law or federal bankruptcy law. A conditional approach would mediate between the requirements of both by preserving the safety net of discharge for those debtors who can demonstrate circumstances sufficient to merit its benefits, but denying it to those who would attempt to abuse bankruptcy by avoiding their restitution obligations in bad faith.

Modelling the discharge provisions of restitution after educational loans, which eschew a bright line approach to dischargeability, is a more effective method of accommodating both state and federal interests. By mediating between state and federal interests, the "conditional" discharge approach avoids favoring state interests at the expense of federal aims and abrogating criminal statutes for the benefit of national economic goals. The fresh start and rehabilitative goals of both federal and state law can be served without sacrificing either to the other.

383. Pennsylvania Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 564 (1990) (Blackmun, J., dissenting).