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Testing the Limits of the Bankruptcy Court's Exclusive Jurisdiction in Fraud Cases: Discharge vs. Criminal Restitution

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COMMENTS

Testing the Limits of the Bankruptcy Court's Exclusive Jurisdiction in Fraud Cases: Discharge vs. Criminal Restitution

I. INTRODUCTION

Ordinarily there is no need for a bankruptcy court to be concerned with criminal proceedings pending against a debtor. "The bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension. Thus, criminal actions and proceedings may proceed in spite of bankruptcy."[1] However, when the debtor in bankruptcy is also the defendant in a criminal action for fraud and the criminal court is inclined or required to impose a restitution requirement on the debtor, determining the extent of each court's authority becomes a problem.

Thus far, Congress has failed to decide if a bankruptcy court's exclusive jurisdiction over fraud issues relating to the debtor's obligations gives the court authority to discharge a criminal court's order of restitution. In addition, Congress has not determined if a criminal court can order restitution of a debt that has been discharged in bankruptcy, or if a bankruptcy court can stay or enjoin a criminal court from entering a judgment compelling payment of the debt when both actions are conducted simultaneously. Since Congress has failed to expressly resolve these questions the courts have had to decide them.

Bankruptcy courts usually view restitution by means of a criminal action as an attempt to evade the discharge or to undermine the bankruptcy court's jurisdiction and, accordingly, enjoin the criminal action[2] under section 105 of the Bankruptcy

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1. H.R. REP. No. 595, 95th Cong., 1st Sess. 432 (1978) (commenting on 11 U.S.C. § 362(b)(1) (Supp. III 1979), the criminal proceeding exception to the automatic stay).

2. *See In re* Penny, 414 F. Supp. 1113 (W.D.N.C. 1976); *see also In re* Alan I.W. Frank Corp., 8 BANKR. CT. DEC. (CRR) 1343 (Bankr. E.D. Pa. Apr. 9, 1982); *In re* Lake, 11 Bankr. 202 (Bankr. S.D. Ohio 1981).

Code or under similar authority in the Bankruptcy Act.[3] On the other hand, criminal courts give little weight to a discharge previously granted in bankruptcy and usually require restitution despite the discharge.[4] Between these extremes are bankruptcy courts that typically refuse to intervene in a criminal action.[5]

The courts of appeals first addressed this problem in *United States v. Carson*.[6] The defendant appealed a federal criminal judgment conditioning probation upon repayment of a debt that had previously been discharged in bankruptcy. The Fifth Circuit held that the court in the criminal action could compel payment notwithstanding the discharge by the bankruptcy court. A few months later, in *Barnette v. Evans*,[7] a state prosecutor appealed from an injunction issued by a bankruptcy court that prevented the entry of a criminal judgment. The criminal judgement mandated restitution of a debt prior to a determination of the debt's dischargeability in bankruptcy. The Eleventh Circuit, adopting *Carson*, held that the bankruptcy judge had "misjudge[d] the width of his turf" and the injunction was dissolved.[8]

These cases are the only decisions from federal appellate courts that are directly on point. They should be seriously questioned.

II. Background

Congress is authorized by the Constitution "to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[9] At the time of the American Revolution, bankruptcy law was seen as a creditor's law designed to punish debtors. The first congressional enactment on the subject, the Bankruptcy Act of 1800, made no provision for voluntary bank-

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3. 11 U.S.C. § 105(a) (1982): "The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *See also* Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

4. *See, e.g.*, United States v. Carson, 669 F.2d 216 (5th Cir. 1982); People v. Mosesson, 78 Misc. 2d 217, 356 N.Y.S.2d 483 (Sup. Ct. 1974).

5. *See, e.g., In re* C.H. Stuart, Inc., 7 Bankr. Ct. Dec. (CRR) 1013 (Bankr. W.D.N.Y. June 23, 1981) (bankruptcy court should not intervene even when creditor is authorized by state law to prosecute criminal action without participation of public prosecutor); *see also* Barnette v. Evans, 673 F.2d 1250 (11th Cir. 1982); *In re* Wagner, 8 Bankr. Ct. Dec. (CRR) 1065 (Bankr. W.D. Mo. Mar. 16, 1982).

6. 669 F.2d 216 (5th Cir. 1982).

7. 673 F.2d 1250 (11th Cir. 1982).

8. *Id.* at 1251.

9. U.S. Const. art. I, § 8, cl. 4.

ruptcy but did provide for an action against the debtor if he committed certain acts of bankruptcy.[10] Later congressional acts, while containing provisions for discharge of the debtor if he cooperated in aiding creditors to realize as much as possible from his estate, were still concerned far more with aiding creditors than with rehabilitating the overextended debtor. A major defect of the law of 1867 was that "it was too easy to throw a debtor into bankruptcy and too hard for him to obtain his discharge after he once became bankrupt."[11]

The Act of 1898 was an effort to provide a system for equitable distribution of an insolvent's assets while at the same time providing the honest debtor with an opportunity to make a fresh start.[12]

Modern bankruptcy law is viewed as a debtor's law. While the law continues to seek a maximum realization for the creditor and prevent fraudulent dissipation of the debtor's estate, a major purpose of the law is to give the honest debtor a fresh start, free from the burdens of hopeless insolvency.[13] This is accomplished through the procedure of discharge. After creditors have gained access to the debtor's assets through the bankruptcy process, the debtor is discharged from future liability to those creditors who have been properly notified and given an opportunity to participate in the proceeding.

Under the 1978 Bankruptcy Code discharge for an individual debtor can take two forms. Chapter 13 provides for an "adjustment" of the debtor's obligation by which he makes periodic payments to creditors in accordance with an approved plan. Upon completion of the plan he receives a discharge from liabilities.[14] Under a Chapter 7 "liquidation" proceeding the property of the debtor (excluding that which is exempted under the law)[15] is distributed to creditors according to the priority of their interest.[16] The debtor is then discharged as to "all debts that arose before the date of the order for relief. . . ."[17]

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10. 1 REMINGTON ON BANKRUPTCY § 7 (J. Henderson 5th ed. 1950).

11. *Id.* at § 9.

12. *Id.* at § 10. *See also* Gleason v. Thaw, 236 U.S. 558 (1915).

13. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

14. Although some of the issues discussed in this comment arise in Chapter 13 cases and in cases involving corporate debtors, the comment is concerned with individual debtors in Chapter 7 liquidations.

15. 11 U.S.C. § 522 (1982).

16. *Id.* § 726.

17. *Id.* § 727(b).

A. The Bankruptcy Court's Exclusive Jurisdiction to Determine Certain Exceptions to the Discharge

Certain debts cannot be discharged in bankruptcy. These are listed in section 523 of the Code.[18] Before 1970 the bankruptcy courts determined whether the debtor merited a discharge under the general provisions of the law. But the determination of whether a particular debt fell under one of the exceptions to dischargeability was left to the court in which the creditor sued, after bankruptcy, to enforce his prebankruptcy claim.[19]

Recognizing the possibilities for abuse that this procedure provided to vindictive creditors, Congress amended the Act in 1970 by placing certain of the dischargeability issues—including the fraud issue—under the exclusive jurisdiction of the bankruptcy court.[20] Before the 1970 amendments the bankruptcy court had authority to protect the debtor from abuse at the hand of courts inexperienced in, and perhaps hostile to, bankruptcy.[21] However, with the grant of exclusive jurisdiction, the bankruptcy court was in a better position to see that debts meriting discharge according to bankruptcy principles were discharged and that postbankruptcy lawsuits were not used to extort payment from a debtor who deserved the release.[22]

B. Automatic Stay Provisions

The bankruptcy court's authority to protect the discharge and prevent the premature and inequitable dissipation of the debtor's assets is further protected by the automatic stay provisions of section 362.[23] It has long been held that the bankruptcy court can enjoin actions which threaten administration of the estate.[24] But it was not until the 1938 Chandler Amendments to

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18. *Id.* § 523.

19. Brown v. Felsen, 442 U.S. 127, 129 (1979).

20. *Id.* at 129-30.

21. *See* Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

22. The exclusive jurisdiction of the 1970 amendments is preserved in the Code by the provisions of § 523(c):

> [T]he debtor shall be discharged from a debt specified in paragraph (2), . . . of subsection (a) of this section, [the fraud exception] unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2) . . . .

23. 11 U.S.C. § 362 (1982).

24. *See Ex parte* Christy, 44 U.S. (3 How.) 292 (1845).

the 1898 Bankruptcy Act that the idea of an automatic stay came into being.

Section 362 of the Bankruptcy Code, improves upon the stay provisions of the original Act. Section 362 creates, with certain exceptions, an automatic stay against all proceedings or any acts designed to affect or procure property from the debtor's estate.[25]

III. Analysis

Allowing criminal courts to order restitution when a discharge has been granted, or when a bankruptcy petition has been filed, cuts directly against basic bankruptcy legislation, policy, and precedent. Congress has committed the dischargeability issue in fraud cases to the exclusive jurisdiction of the bankruptcy courts, and the *Carson* rule undermines that jurisdiction. Also, the objectives and safeguards of section 523 of the Bankruptcy Code are frustrated if criminal courts are allowed to circumvent the discharge. Circumvention of the bankruptcy system cannot be justified in the name of criminal sanction since the criminal court's restitution order does not impose a sanction in the traditional sense, but rather coerces repayment of the debt. Such coercion has been condemned when it results in avoidance of the bankruptcy discharge.

A. The Criminal Action Exception to Bankruptcy Stays

One exception to the automatic stay is section 362(b)(1), which excepts "the commencement or continuation of a criminal action or proceeding against the debtor"[26] from the stay's operation. However, exception to the automatic stay does not determine the extent of the bankruptcy court's jurisdiction with respect to injunctive relief. Section 105 gives the court power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[27] The legislative history of section 362—which creates various exceptions to the automatic stay—makes it clear that Congress was not manifesting an intent that the court refrain from intervening in such

25. *See* 11 U.S.C. § 362(a) (1982).
26. *Id.* § 362(b)(1).
27. *Id.* § 105.

cases. Congress intended the courts to intervene on a case by case basis.[28]

Bankruptcy courts are not normally concerned with a debtor's moral character, but rather deal with his financial obligations to creditors. On the other hand criminal courts do focus on the defendant's moral character and generally do not deal with the financial aspects of his life. Therefore, there is seldom a need for the bankruptcy court to concern itself with criminal matters.

However, there is a situation in which jurisdictions overlap. The bankruptcy court under 11 U.S.C. § 523(a)(2),[29] as under the predecessor section 17(a)(2) of the Bankruptcy Act,[30] is re-

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28. According to the Senate Judiciary Committee:

> Subsection (b) lists seven exceptions to the automatic stay. The effect of an exception is not to make the action immune from injunction.
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> The court has ample other powers to stay actions not covered by the automatic stay. Section 105, of proposed title 11, derived from Bankruptcy Act, § 2a(15), grants the power to issue orders necessary or appropriate to carry out the provisions of title 11. The district court and the bankruptcy court as its adjunct have all the traditional injunctive powers of a court of equity, 28 U.S.C. [§] 151 . . . and 28 U.S.C. § 1334 . . . . Stays or injunctions issued under these other sections will not be automatic upon the commencement of the case, but will be granted or issued under the usual rules for the issuance of injunctions. By excepting an act or action from the automatic stay, the bill simply requires that the trustee move the court into action, rather than requiring the stayed party to request relief from the stay. There are some actions, enumerated in the exceptions, that generally should not be stayed automatically upon the commencement of the case, for reasons of either policy or practicality. Thus, the court will have to determine on a case-by-case basis whether a particular action which may be harming the estate should be stayed.

S. REP. No. 989, 95th Cong., 1st Sess. 51 (1978).

29. 11 U.S.C. § 523(a)(2) (1982) excepts from discharge any debt:

> (2) for obtaining money, property, services, or an extension, renewal, or refinance of credit, by—
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> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; or
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> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
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> (iii) on which the creditor to whom the debtor is liable for obtaining such money, property, services, or credit reasonably relied; and
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> (iv) that the debtor caused to be made or published with intent to deceive.

30. Section 17(a)(2) of the Bankruptcy Act, as codified in 11 U.S.C. § 35(a)(2) (1976) (repealed 1978), excepted from discharge debts which:

> (2) are liabilities for obtaining money or property by false pretenses or false representations, . . . or for obtaining an extension or renewal of credit in reli-

quired to leave the realm of the debtor's financial affairs to scrutinize the debtor's moral character and the fraudulent activities connected with his debts when determining if the debtor deserves discharge. At the same time, statutes in many states and provisions of the federal criminal law permit, and in some instances require, criminal courts to intervene in the defendant's relationship with creditors by requiring him to make restitution to these creditors when there is fraud relating to the underlying debt.[31] When this situation arises one court or the other must yield.

B. The Bankruptcy Court's Power to Examine the Merits of a Criminal Court's Restitution Order

The "fraud" that makes a person criminally liable may not always make the debt nondischargeable.[32] The policy behind bankruptcy has led courts and commentators to agree that "[a] remedial statute, like that of bankruptcy intended for the relief of debtors, must, insofar as denial of discharges and therefore of relief, be construed strictly so that all debts except those coming exactly within the exception will stand discharged."[33] As a result of this policy, a finding of fraud sometimes creates conflict between the bankruptcy and criminal systems. In some instances, the boundaries of nondischargeable fraud in bankruptcy are less extensive than those encompassing criminal fraud. For example, some states have laws which impose criminal liability for writing checks with insufficient funds without a showing of intent to defraud. Under these statutes fraud is said to be implied,[34] but it

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ance upon a materially false statement in writing respecting his financial condition made or published . . . in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another . . . .

31. Restitution is ordered for crimes other than fraud. Whether there is a conflict between the restitution order in such a case and the bankruptcy law is beyond the scope of this comment.

32. By assuming that a criminal court finding of fraud would automatically prevent discharge, the *Barnette* court made a crucial error contributing to the ultimate erroneous decision. *See* Barnette v. Evans, 673 F.2d 1250, 1252 (11th Cir. 1982).

33. Davison-Paxon Co. v. Caldwell, 115 F.2d 189, 191 (5th Cir. 1940), *cert. denied*, 313 U.S. 564 (1941); *see also* Gleason v. Thaw, 236 U.S. 558 (1915).

34. *See, e.g.*, State v. Daymus, 90 Ariz. 294, 367 P.2d 647 (1961) (law requires funds or credit sufficient to pay check upon presentation; defendant *not* entitled to instruction exculpating him if he reasonably expected payment at time of uttering check); State v. Morris, 190 Kan. 93, 372 P.2d 282 (1962) (defendant must know that the funds are insufficient at the time of uttering, but intent to defraud is not an element of crime); *see also* 2 R. ANDERSON, WHARTON'S CRIMINAL LAW AND PROCEDURE § 613 (1957).

has been established since *Neal v. Clark*[35] that the type of fraud subject to the Bankruptcy Act is

> positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality. Such a construction of the statute is consonant with equity, and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency. A different construction would be inconsistent with the liberal spirit which pervades the entire bankrupt [sic] system.[36]

In a state that punishes the issuer of a bad check without a showing of positive fraud, the debtor could be guilty of the "crime" of uttering a worthless check even though the debt incurred by the same check is dischargeable.[37]

There is some authority for the proposition that hankruptcy fraud is substantially different from other kinds of fraud. In *Davison-Paxon Co. v. Caldwell*,[38] a widely criticized decision,[39] the Fifth Circuit held that purchasing goods with no present intention to pay did not constitute false pretenses or false representations under the Bankruptcy Act because the debtor had made no manifestations concerning his intent, though the action was conceded to be fraudulent under common law.[40] *Caldwell* is an erroneous decision. However, it can be persuasively argued that the court erred, not in recognizing a valid distinction between bankruptcy fraud and state law fraud, but in attempting to distinguish bankruptcy fraud from other fraud by determining that elements of the one were not elements of the other. Fraud is fraud whether in bankruptcy or criminal proceedings.

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35. 95 U.S. 704 (1877).

36. *Id.* at 709; *see also* 3 COLLIER ON BANKRUPTCY ¶ 523.08[5], at 523-49 (L. KING 15th ed. 1983): "[S]ection 523(a)(2)(A) was intended to codify case law as expressed in *Neal v. Clark* which interpreted 'fraud' to mean actual or positive fraud rather than fraud implied by law."

37. *See In re* Godfrey, 472 F. Supp. 364, 367 (N.D. Ala. 1979) (Bankruptcy Act requires specific positive intent to cheat or swindle whereas under the Alabama Worthless Check Act the fraud is implied).

38. 115 F.2d 189 (5th Cir. 1940).

39. *See, e.g.*, 3 COLLIER ON BANKRUPTCY ¶ 523.08, at 523-46 n.20 (L. KING 15th ed. 1983).

40. 115 F.2d at 191. While *Caldwell* did not deal with a criminal statute, it illustrates the difficulty courts have had in applying the fraud exceptions to the bankruptcy discharge.

What *Neal v. Clark* emphasized as a distinction was not the elements of the offense, but the procedures for determining its existence.

Two policies underlie criminal fraud statutes. The first policy is a general abhorrence of dishonesty and a recognition of society's need to punish those who are caught violating criminal fraud statutes. When Congress adopted the fraud exceptions to the bankruptcy discharge, it was expressing this ahhorrence for dishonesty. The second policy underlying criminal fraud statutes is the need to promote commercial stability by fostering confidence that transactions will be carried out, either voluntarily or through judicial coercion. This need justifies the implication of fraud in certain criminal contexts.[41] Since a debtor's relief in bankruptcy is the antithesis of laws promoting reliability in commercial transactions, it can hardly be argued that Congress was concerned with promoting commercial stability in formulating the Bankruptcy Code. Therefore, while it may make sense to infer fraud in the criminal court in the bad check situation in order to promote commercial stability, a different rule should prevail in bankruptcy because commercial stability is no longer a factor.

Determining the scope of the fraud exception to discharge under procedures designed to effectuate bankruptcy objectives was one of the considerations that led to the 1970 Bankruptcy Act amendments. These amendments gave the bankruptcy courts exclusive jurisdiction of this type of dischargeability question.

In *Brown v. Felsen*[42] the Supreme Court, commenting on the 1970 amendments, said,

> If a state court should expressly rule on § 17 questions,[43] then giving finality to those rulings would undercut Congress' intention to commit § 17 issues to the jurisdiction of the bankruptcy court. The 1970 amendments eliminated postbankruptcy state-court collections suits as a means of resolving certain § 17 dischargeability questions. In those suits creditors had taken advantage of debtors who were unable to retain counsel because bankruptcy had stripped them of their assets. Congress' pri-

41. State v. Avery, 111 Kan. 588, 590-91, 207 P. 838, 839 (1922).

42. 442 U.S. 127 (1979).

43. The *Felsen* Court acknowledged the Bankruptcy Reform Act of 1978, indicating that its holding, based on § 17 of the Bankruptcy Act, would be valid precedent for cases arising under § 523 of the Code. *See* 442 U.S. at 129 n.1.

> mary purpose was to stop that abuse. A secondary purpose, however, was to take these § 17 claims away from state courts that seldom dealt with the federal bankruptcy laws and to give those claims to the bankruptcy court so that it could develop expertise in handling them. By the express terms of the Constitution, bankruptcy law is federal law, U.S. Const., Art. I, § 8, cl. 4, and the Senate report accompanying the amendment described the bankruptcy court's jurisdiction over these § 17 claims as "exclusive." . . . [I]t would be inconsistent with the philosophy of the 1970 amendments to adopt a policy of res judicata which takes these § 17 questions away from bankruptcy courts and forces them back into state courts.[44]

Under the Supreme Court's explanation of the 1970 amendments, it would clearly be within the bankruptcy court's jurisdiction to reexamine the controversy that led to the criminal restitution order so as to determine its purpose.[45] If the conviction was obtained under procedures requiring a finding of moral turpitude, the bankruptcy court should probably refuse to discharge the debt.[46] If no positive fraud or imputation of bad faith was necessarily proved in the criminal action, the court could properly discharge the debt created by the restitution order.

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44. *Felsen*, 442 U.S. at 135-36; *see also id.* at 136 n.7.

45. The *Felsen* Court limited its holding to the issue of res judicata:

> This case concerns res judicata only, and not the narrower principle of collateral estoppel. Whereas res judicata forecloses all that which might have been litigated previously, collateral estoppel treats as final only those questions actually and necessarily decided in a prior suit. . . . If, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17, then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court.
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> Because respondent does not contend that the state litigation actually and necessarily decided either fraud or any other question against petitioner, we need not and therefore do not decide whether a bankruptcy court adjudicating a § 17 question should give collateral-estoppel effect to a prior state judgment. In another context, the Court has held that a bankruptcy court should give collateral-estoppel effect to a prior decision. *Heiser v. Woodruff*, 327 U.S. 726, 736 (1946). The 1970 amendments to the Bankruptcy Act, however, have been interpreted by some commentators to permit a contrary result. See 1A J. Moore, J. Mulder & R. Oglebay, Collier on Bankruptcy § 17.16[6], p. 1650.2 (14th ed. 1978); Countryman, The New Dischargeability Law, 45 Am. Bankr. L.J. 1, 49-50 (1971). But see 1 D. Cowans, Bankruptcy Law and Practice § 253 (1978).

442 U.S. at 139 n.10. Should the prebankruptcy criminal action find "positive fraud" with imputation of "bad faith," that finding may have a collateral estoppel effect under some circumstances.

46. *See In re* Taylor, 16 Bankr. 323 (D. Md. 1981).

C. *Exclusive Jurisdiction Mandates That a Determination of Dischargeability Be Final on the Issue of Payment*

Perhaps more important than the bankruptcy court's ability to reopen the facts leading to a criminal court order of restitution is the court's ability to prevent its determination of dischargeability from being undermined by another court's order to pay the debt. In collateral proceedings other courts overstep their bounds and violate express congressional prohibition if they compel payment despite discharge in bankruptcy.[47] No exception should be made for criminal courts.

The criminal law has important interests to protect which go beyond collection of debts for defrauded creditors. Thus, a significant amount of tension is created when the two systems deal with the same defendant on a fraud issue. But this tension should not be used to justify erosion of the procedural safeguards built into the Bankruptcy Code.

The tension reaches its greatest intensity in cases such as *Carson*. In *Carson* the debtor had committed actual fraud, which would have prevented discharge of the debt had tbe issue been raised in the bankruptcy proceeding as required by section 523(c).[48] The criminal court ordered the debtor to pay the discharged debt which is not surprising since bankruptcy's relief is not intended for debtors guilty of criminal fraud. However, criminal courts could impose alternative sanctions which would vindicate the law, but not give creditors the incentive to avoid the bankruptcy court's jurisdiction. The *Carson* rule should not be followed because of the abuse to the bankruptcy system that it would invite.[49]

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47. 11 U.S.C. § 524(a) (1982) provides:

> (a) A discharge in a case under this title—
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> . . . .
>
> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect, recover or offset any such debt as a personal liability of the debtor, or from property of the debtor, whether or not discharge of such debt is waived . . . .

48. The record indicates that the creditor, Fulton National Bank, had knowledge of the fraud before the discharge. Brief for Appellant at 18, United States v. Carson, 669 F.2d 216 (5th Cir. 1982). *Accord*, Brief for Appellee at 17. Hence the creditor could, and should, have raised the fraud issue in the bankruptcy court.

49. Congress no doubt recognized that cases like *Carson* would arise given the time limit § 523(c) puts on raising the fraud issue in the bankruptcy proceedings and the provision that the debt, though fraudulent, is discharged unless raised within the time limit. Thus, there is no legal justification for the *Carson* decision unless the involvement of the criminal court mandates a special rule. *See In re* Godfrey, 472 F. Supp. 364, 370

Any exception to discharge becomes a target for abuse. Since fraudulently incurred debts are not dischargeable, creditors are tempted to claim "fraud" even when no fraud has occurred. Congress provided safeguards against this kind of abuse. The most significant protection is that the Bankruptcy Code requires the fraud issue to be tried in the bankruptcy proceeding under section 523(c). This exclusive jurisdiction bolsters the long recognized duty of the bankruptcy court to protect the integrity of the discharge[50] by assuring that bankruptcy law, not state law, determines the dischargeability question. In addition, under section 523(d),[51] if the creditor alleges fraud and loses, he must pay the debtor's costs and attorney's fees.[52] These provisions not only deter unfounded allegations of fraud, but also protect the debtor should the creditor, outraged by the bankruptcy, try to use the fraud claim to extort payment from the debtor.[53]

If the criminal court is permitted to circumvent these protective procedures by ordering restitution in a collateral action, creditors would no longer be deterred by the attorney fee sanction of section 523(d). Since the alternative procedure may make the proof of fraud easier, creditors would have incentive to turn their debt collection over to the county prosecutor.[54] Even worse, under some state procedures the creditor could prosecute the fraud proceeding himself without the intervention of a public official.[55] As a result, the purposes of section 523(d) would be

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(N.D. Ala. 1979), *citing* Matter of Love, 577 F.2d 345, 346 (5th Cir. 1978).

50. *See* Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

51. 11 U.S.C. § 523(d) (1982) provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment against such creditor and in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding to determine dischargeability, unless such granting of judgment would be clearly inequitable.

52. Section 523(d) is limited to cases involving consumer debt.

53. "The purpose of the provision is to discourage creditors from initiating proceedings . . . in the hope of obtaining a settlement from an honest debtor anxious to save attorney's fees. Such practices impair the debtor's fresh start and are contrary to the spirit of the bankruptcy laws."

S. REP. No. 595, 95th Cong., 2d Sess. 80 (1978).

54. While the "beyond a reasonable doubt" criminal standard alleviates some of this potential, given the "clear and convincing" standard of bankruptcy fraud determinations coupled with bankruptcy's attitudes, procedures, and sanctions designed to protect the debtor, the criminal court probably still looks more promising to a creditor contemplating an allegation of fraud.

55. *See In re* C.H. Stuart, Inc., 7 BANKR. CT. DEC. (CRR) 1013 (Bankr. W.D.N.Y. June 23, 1981).

frustrated and the section 523(c) grant of exclusive jurisdiction would be seriously undermined. The net effect would be to force section 523(a)(2) issues "back into state courts,"[56] thus defeating the purpose of the 1970 amendments.

On the other hand, no benefit that Congress intended the truly defrauded creditor to receive is lost by rejecting the *Carson* rational. If the creditor follows the procedure of section 523(c) and the debt is found to be nondischargeable, the creditor can then collect the debt out of postbankruptcy assets, perhaps through a criminal proceeding ordering the defendant to make restitution. Clearly, if the exclusive jurisdiction of the bankruptcy court is to accomplish the goals of the 1970 amendments, no collateral court—not even a criminal court—can be allowed to second-guess the dischargeability determination.

D. Restitution As a "Criminal Sanction"

It has been argued that although the bankruptcy law may prevent a criminal court from ordering the debtor to pay a debt, restitution is not payment of the debt, but rather a sanction imposed upon the debtor because of his crime. Therefore, the criminal court may order restitution just as it may require time in prison or the payment of a fine.[57] Not only does this rationale lead to the same end prohibited by the bankruptcy law if the debt was properly discharged, but closer analysis shows that it follows a prohibited path in getting there. The extent of the so-called sanction is not determined by the seriousness of the crime or the character of the defendant (as is a fine or a prison sentence). The measure of the sanction is the debt. If an absent minded first offender writes a $5,000 bad check, his sanction is $5,000. If a $50 debt is incurred by a recidivist con-man, his sanction is $50. This treatment is only fair in the civil context, as it makes the victim whole, but not in the criminal context, since it does not deter future criminals or significantly impress the defendant with the wrongfulness of his action.[58]

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56. *See* Brown v. Felsen, 442 U.S. 127, 136 (1979).

57. In *Carson* the government agreed in the beginning that the lower court had erred in "ordering restitution on the debt which previously had been discharged in bankruptcy." Brief for Appellee at 18, United States v. Carson, 669 F.2d 216 (5th Cir. 1982). But on reflection, the government formulated the sanction rationale which, although not well articulated, underlies the *Carson* reasoning. *See* Supplemental Brief for Appellee.

58. It can be said that the criminal law has a third purpose, which is to appease society by requiring every man to pay his just dues, and that restitution fulfills this

Other factors further demonstrate that restitution is a collection of the debt rather than a true criminal sanction. For instance, the money is paid to the creditor and not to the state.[59] The defendant cannot be required to make restitution if he has once paid the creditor.[60] In addition, the limits of restitution are derived from what the complaining witness could have recovered in a civil action against the defendant.[61]

Efforts by the state to ensure recovery to victims of fraud through the exercise of the state's police power are laudable in most instances, but *Carson* illustrates the sanction argument's incongruence with bankruptcy policy. *Carson* held that a federal court in a criminal action could make restitution of a debt previously discharged in bankruptcy a condition of probation, since the focus of restitution is not on making the creditor whole but on rehabilitating the defendant. According to the court, "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 . . . ."[62]

The problem with this rationale is that it ignores the presence of a bankruptcy issue in the case. It argues against discharge irrespective of the fraud issue. Making the debtor pay his debts can "strengthen his sense of responsibility," it can teach the debtor "to consider more carefully the consequences of his actions," and if successful will give the debtor "a positive sense of having earned a fresh start." However, Congress determined that these salutary aspects of forcing the debtor to pay are not to be preferred above the discharge granted in bankruptcy cases.

In any event, the Supreme Court in *Perez v. Campbell*[63] rejected the sanction rationale in a context that should control the

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purpose. But, since this reasoning would destroy the validity of any bankruptcy discharge, criminal courts cannot be allowed to carry out this function when to do so would undermine the result intended by bankruptcy policy.

59. Some states have sanctions called "restitution" which are in reality a fine that the defendant pays to the state. These obligations are true sanctions and are not, of course, included in the analysis of this comment.

60. Compromise of the victim's claim normally does not preclude imposition of criminal sanctions. *See, e.g.*, Hensel v. State, 585 P.2d 878, 880 (Alaska 1978); State v. Duffy, 33 Or. App. 301, 576 P.2d 797 (1978).

61. *See, e.g.*, UTAH CODE ANN. § 76-3-201 (Supp. 1984).

62. *Carson*, 669 F.2d at 218, *quoting* Hugget v. State, 83 Wis. 2d 790, 798, 266 N.W.2d 403, 407 (1978).

63. 402 U.S. 637 (1971).

fraud restitution issue. Under the Arizona Motor Vehicle Safety Responsibility Act, any person who failed within sixty days to satisfy a judgment arising out of an automobile accident would have his driver's license suspended until the debt was paid. The statute provided that a discharge in bankruptcy did not affect this duty. The Court held that this provision of the statute circumvented the bankruptcy act and was therefore invalid.[64]

In ruling as it did in *Perez*, the Court found it necessary to reject its earlier holdings on point. One of these was *Kesler v. Department of Public Safety*,[65] in which the Court had justified a similar provision under the sanction rationale by stating:

> We held in *Reitz [v. Mealy]*[66] that [a state] might impose this [debt payment] requirement despite a discharge, in order not to exempt some drivers from appropriate protection of public safety by easy refuge in bankruptcy.
>
> . . .The Safety Responsibility Act is not an Act for the Relief of Mulcted Creditors.[67]

In rejecting the sanction rationale and the *Kesler* holding, the *Perez* court concluded that if the effect of a statute is to protect creditors by giving them a powerful weapon with which to force bankrupts to pay their debts despite their discharge, then it cannot validly operate. Though it is called a sanction and is not designed to aid collection of debts but to enforce a legitimate public policy such as deterring irresponsible driving, the statute invalidly circumvents bankruptcy policy.[68]

Presumably, since it is improper for a legislature to directly coerce payment of a discharged debt by conditioning driving privileges on such payment, it is also improper for a court to condition probation from prison on repayment or restitution of a debt properly discharged in bankruptcy.[69]

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64. *Id.* at 656.

65. 369 U.S. 153 (1962).

66. 314 U.S. 33 (1941).

67. 369 U.S. at 173-74.

68. 402 U.S. at 650-54.

69. The *Carson* court argued that since nothing in the federal restitution provisions prevents ordering restitution of a debt discharged in bankruptcy, Congress must impliedly have given the criminal courts authority to subvert the Bankruptcy Act. *See* 669 F.2d at 217 & n.1. That argument is put to rest in *Perez* and should not be followed. The dissent in *Perez* argued that the discharge provisions of the Bankruptcy Act had to be interpreted narrowly enough to accommodate the challenged law since Congress had enacted the same provision in the District of Columbia. *See* 402 U.S. at 665. The majority rejected this suggestion. While agreeing that "such an argument assumes a modicum of legislative attention to the question of consistency," *id.* at 655, the majority felt it was

IV. Application: A Suggested Interpretation of the Criminal Proceeding Exception to the Automatic Stay

Section 362, the automatic stay provision of the Bankruptcy Code, provides, with certain exceptions, that all acts or proceedings pending against the debtor are stayed by the filing of a bankruptcy petition.[70] One exception is for criminal proceedings. Under the view developed in this comment, the restitution portion of any criminal conviction relating to the discharged debt will become null and void once discharge is granted under section 524(a).[71] This being the case, it would not be unreasonable for the courts to interpret the criminal proceeding exception to the automatic stay[72] narrowly enough that, while the criminal action may proceed, no order of restitution could be made pending the outcome of the bankruptcy proceeding.[73] This interpretation accords with the major impetus behind the 1978 bankruptcy reform, which was to expand the jurisdiction of the bankruptcy court so as to eliminate the serious delays, expense, and duplications involved in bankruptcy proceedings.[74] It is also consistent with the need to protect the exclusive jurisdiction of the bankruptcy court to determine discharges under section 523(c). The competing policies in the criminal and bankruptcy systems require such reasoning in order to protect the bankruptcy jurisdiction. The *Carson/Barnette* reasoning, that the

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probable that "Congress gave no attention to the interaction of the antidischarge section [of the D.C. Code] with the Bankruptcy Act." *Id.* Therefore, even the D.C. Code's express reference to discharge did not mandate, as the dissent asserted, a reinterpretetion of the effect of the discharge. It was clearly abberational for the *Carson* court to find an implied limitation to the discharge in the silent restitution statute when the Supreme Court had held that an express reference to discharge did not have that effect.

70. 11 U.S.C. § 362 (1982).

71. 11 U.S.C. § 524(a)(1) (1982) provides:

> (a) A discharge in a case under this title—
>
> (1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, or 1328 of this title, whether or not discharge of such debt is waived.

See also In re Barnett, 15 Bankr. 504 (Bankr. D. Kan. 1981).

72. 11 U.S.C. § 362(b)(1) (1982).

73. Congress adopted a similar approach with respect to exercise of the state's regulatory power by allowing the state to continue to enforce the regulation, but precluding collection of a fine from property of the estate. *See* 2 Collier on Bankruptcy ¶ 362.05 at 362-38. (L. King 15th ed. 1983); *see also In re* Johnson, 8 Bankr. Ct. Dec. (CRR) 727 (Bankr. M.D. Fla. Dec. 2, 1981).

74. S. Rep. No. 989, 95th Cong., 2d Sess. 17, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5803, 5804.

criminal action is of no concern to the bankruptcy court, is inappropriate.[75]

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75. In fairness to the *Barnette* court it bears noting that the injunction there dissolved was directed at the entire criminal proceeding. The injunction in that instance was probably overbroad. The court reasoned that *Younger v. Harris* principles prevent undue interference by federal courts into state criminal proceedings. In fact, nonintervention concerns have become so intense in recent years that they would perhaps hinder the interpretation of § 362(b)(1) advocated in this paragraph. Nonetheless, the bankruptcy policy to be furthered is so great, and the contemplated interference, designed solely to protect the debtor's financial estete, is so slight that the interpretation would not be inconsistent with the federal policy against intarvention. *See* 2 COLLIER ON BANKRUPTCY ¶ 362.05, at 362-38 (L. KING 15th ed. 1983) and cases cited; *see also In re* Godfrey, 472 F. Supp. 364 (1979) (injunction denied, but order preventing creditors from receiving payments in restitution issued).