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A Separate Classification for Criminal Debt in Chapter 13

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NOTES

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INTRODUCTION

In order to make Chapter 13 more accessible and attractive to individual debtors, Congress enacted the Bankruptcy Reform Act of 1978.[1] With the new provisions, debtors have more latitude to work out debt composition plans and thus avoid the humiliation and stigma of a straight bankruptcy.[2] A Chapter 13 proceeding is strictly voluntary[3] and serves as an alternative to Chapter 7 liquidation,[4] by offering debtors a chance to work out their financial difficulties under a rehabilitation plan. Unlike a Chapter 7 debtor, a Chapter 13 debtor does not lose possession of his property to a trustee; he maintains control of his property throughout the Chapter 13 case without any judicial interference.[5] The Chapter 13 plan requires not merely a debtor's consent, but a positive determination by the debtor and his family to live within the financial constraints imposed by the plan.[6]

In creating new Chapter 13 legislation, Congress altered the provisions to expand the class of debtors who could take advantage of Chapter 13. Chapter 13 relief was formerly restricted to wage earner debtors; however, Chapter 13 is currently available to any individual with regular income, regardless of its source.[7] As incentive for debtors to complete performance under a Chapter 13 plan, any debtor who carries out his plan is entitled to discharge of almost all debts.[8] A Chapter 13 debtor therefore may be discharged from a variety of debts which a Chapter 7 debtor remains obligated to pay at the conclusion of a liquidation.[9] Congress' promotion of Chapter 13 as an

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1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. § § 101 to 151326 (1982 & Supp. III 1985)). The Bankruptcy Reform Act replaced the Bankruptcy Act of 1898 which proved unworkable with the more complex problems of modern consumer and business finance. R. GINSBERG, BANKRUPTCY 1011 (1985).

2. *In re* Rimgale, 669 F.2d 426, 427 (7th Cir. 1982).

3. 11 U.S.C. §§ 303(a), 706(c), 1112(d) (1982 & Supp. III 1985).

4. 11 U.S.C. §§ 701-66.

5. 11 U.S.C. § 1306.

6. *In re* Iacovoni, 2 Bankr. 256 (Bankr. D. Utah 1980).

7. 11 U.S.C. § 109(e).

8. 11 U.S.C. § 1328(a) states: "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 debts under § 1322(b)(5) (default debts) and § 523(a)(5) (support payments).

9. *Rimgale,* 669 F.2d at 427, 428. Chapter 7 generally holds the following debts nondischargeable: debts based on taxes, fraud, misrepresentation, embezzlement or larceny; debts for

alternative to straight bankruptcy is commendable in principle for "he with his Chapter 13 payments feeds three: himself, his hungering creditor, and some others."[10] The Chapter 13 debtor benefits from the discipline, legal protection and mental satisfaction of fulfilling his obligations. By gaining access to the debtor's future income, the creditors also benefit by generally receiving more than they would in a Chapter 7 liquidation.[11]

The extremely generous discharge provision of Chapter 13 gives rise to criticism that such bankruptcies are a "haven for criminals" because debts incurred as a result of criminal activity may be discharged.[12] Frustrated by the liberal discharge provisions of Chapter 13, creditors are increasingly invoking state criminal statutes to pressure debtors into "voluntarily" paying debts which are otherwise dischargeable.[13] The irony in this situation is that federal bankruptcy laws are created to protect debtors from the threat of debt imprisonment and to relieve their financial burdens,[14] but now the threat of imprisonment is becoming a reality despite the protection offered by Chapter 13. Because state legislatures are enacting laws which establish criminal penalties for unpaid debts, the debtor may face criminal prosecution for his pre-bankruptcy activities, even though the debt may be declared dischargeable by the bankruptcy court.[15] The prospect of restitutionary recovery in the criminal courts affords creditors an incentive to prosecute (or threaten to prosecute) debtors in the hope of recouping losses.[16] This gives creditors leverage to pressure debtors into "voluntary" payment of debts or else face incarceration.[17]

In real terms, the creditors' use of criminal courts to force payment or incarceration circumvents the dual legislative purposes of Chapter 13: orderly

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alimony and child support; debts based on willful and malicious injuries to persons or property; debts based on noncompensatory government fines, penalties and forfeitures; student loans and drunk driving debts. *See* 11 U.S.C. § 523(a)(1)-(10).

10. *In re* Seely, 6 Bankr. 309, 311 (Bankr. E.D. Va. 1980).

11. The only exception when creditors do not receive more in Chapter 13 than Chapter 7, is where a court adopts the minority view expressed in *In re* Sutherland, 3 Bankr. 420 (Bankr. W.D. Ark. 1980). *See infra* note 77 and accompanying text. This analysis has led to controversial zero payment plans. *See* Note, *Good Faith, Zero Plans, and the Purposes of the Bankruptcy Code Chapter 13: A Legislative Solution to the Controversy,* 61 B.U.L. REV. 773 (1981).

12. *In re* Newton, 15 Bankr. 708 (Bankr. N.D. Ga. 1981).

13. Kratsch & Young, *Criminal Prosecutions and Manipulative Restitution: The Use of State Criminal Courts for Contravention of Debtor Relief,* 1984 ANN. SURV. OF BANKR. L. 107. *See also* Schutz, *Bankruptcy and the Prosecutor: When Creditors use Criminal Courts to Collect Debts,* FLA. BAR J., May 1985, at 11.

14. Kratsch & Young, *supra* note 13, at 107.

15. An example of such a situation is in the case *In re* Anson, 9 Bankr. 741 (Bankr. W.D. Mo. 1981), where the bankruptcy court found debts resulting from checks written on an account with insufficient funds to be dischargeable. The debtor then had to request the district court to enjoin the state criminal prosecution. *Id.*

16. Kratsch & Young, *supra* note 13, at 108.

17. *Id.*

liquidation and a fresh financial start for the debtor.[18] Forcing the debtor to pay or go to jail discourages the use of Chapter 13. If a debtor is forced to pay his criminal debt in full, he is likely to elect a Chapter 7 bankruptcy to discharge all allowable debts and concentrate his efforts on satisfying the criminal debt in order to avoid jail. This result ultimately hurts both the debtor and his creditors; the debtor is unable to enjoy the benefits of Chapter 13, while the creditors are denied access to payments from the debtor's future income and lose any chance of minimizing their losses. Only the creditor who was fortunate enough to be the beneficiary of a criminal recovery statute receives the full value of his claim. A recovery of this sort is contrary to the philosophy of the Bankruptcy Code.[19] Part I of this Note discusses how current solutions impair the functions of Chapter 13. Part II then explores debt classification as a potential solution and concludes with the recommendation that a new classification for criminal debt is needed.

I. CURRENT SOLUTIONS IMPAIR THE FUNCTIONS OF CHAPTER 13

The Bankruptcy Code embodies the congressional goals of protecting both debtors and creditors and specifies which debts are entitled to a discharge in bankruptcy. If the debtor brings himself within the provisions of the Code, he is entitled to the statutory discharge.[20] A creditor's use of the state criminal statutes to circumvent Chapter 13, however, poses a potential conflict under the Supremacy Clause.[21] The automatic stay provision of 11 U.S.C. § 362 does not operate as a stay of the commencement or continuation of a criminal action against the debtor.[22] A criminal debt prosecution therefore is not stayed. Section 105(a) of Title 11, however, allows the federal bankruptcy court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.[23]

Enjoining the state criminal prosecution pursuant to section 105(a) results in a conflict between federal and state law. The Supremacy Clause mandates that the Constitution and federal laws be "the supreme Law of the Land."[24] In the event of conflict, federal law completely supersedes state law except where the federal law makes express exceptions or fails to cover the entire subject.[25] Where federal statutes concern paramount federal interests, the federal system is assumed to preclude enforcement of state law.[26] The Su-

18. Hendel & Reinhardt, *Inhibiting Post Petition "Bad Check" Criminal Proceedings Against Debtors: The Need for Flexing More Judicial Muscle,* COM. L.J., May 1984, at 235, 240.
19. Kratsch & Young, *supra* note 13, at 112.
20. This automatic result is due to the constitutional doctrine of federal supremacy.
21. U.S. CONST. art. VI, cl. 2.
22. 11 U.S.C. § 362.
23. 11 U.S.C. § 105(a).
24. U.S. CONST. art. VI, cl. 2.
25. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 234-36 (1947).
26. Pennsylvania v. Nelson, 350 U.S. 497, 504 (1956).

premacy Clause of the Constitution[27] therefore prohibits any state from depriving the bankrupt of the benefits the federal law provides him. No state actor can inflict any penalty, direct or indirect, upon the bankrupt for failing to pay his debts in full.[28] The effect of a criminal proceeding, not stayed by the automatic stay provision of Chapter 13, exposes the bankrupt to conflicting duties. On one hand, the bankruptcy court will discharge a criminal debt as long as the required percentage is paid. On the other hand, a state court will order the criminal debt to be paid in full, or the debtor will go to jail.[29]

A. Injunctions

One solution to this dilemma is for the debtor to petition the bankruptcy court pursuant to section 105(a)[30] for injunctive relief from state criminal proceedings. Since an injunction is an extraordinary remedy issued only under the most urgent of circumstances, the debtor has a difficult burden petitioning for relief because any doubt results in a denial of the injunction.[31]

This anti-injunction policy rests, in part, upon the traditional constitutional independence of the states and their courts.[32] Federal courts have historically avoided interfering in state court affairs so to preserve the integrity and competence of state judicial processes.[33]

In most cases[34] involving criminal debtors' petitions for relief, the federal courts rely on the stringent *Younger v. Harris*[35] standard. This standard prohibits federal courts from enjoining state criminal prosecutions except where extraordinary circumstances warrant such action.[36] Relief may be granted only where the danger of irreparable harm is both great and immediate, and threatens the petitioner's federally protected rights.[37] The *Younger* Court further explained that certain types of injuries, such as the cost,

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27. U.S. CONST. art. VI, cl. 2.
28. *In re* Hicks, 133 F. 739, 744 (N.D.N.Y. 1905).
29. Kratsch & Young, *supra* note 13, at 111.
30. 11 U.S.C. § 105(a).
31. *See* Vendo Co. v. Lektro-Vend Corp., 433 U.S. 623, 630 (1977).
32. Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Engineers, 398 U.S. 281, 287 (1970).
33. *Id.* at 286.
34. Hendel & Reinhardt, *supra* note 18, at 240.
35. 401 U.S. 37 (1971).
36. The policy behind this standard is that:

> [F]ederal courts should use restraint when their decisions might interfere with traditional state functions. There is no more appropriate application fo [sic] that policy than in the area of criminal law where states have a primary responsibility to promote the safety and welfare of their citizens through the enforcement of their criminal status. This policy, which extends to noninterference with state criminal proceedings is endorsed by the Bankruptcy Reform Act . . . .

In re Oslager, 46 Bankr. 58, 62 (Bankr. M.D. Pa. 1985) (quoting *In re* Pellegrino, 42 Bankr. 129, 138 (Bankr. D. Conn. 1984)).
37. *Younger*, 401 U.S. at 43, 46.

anxiety and inconvenience of having to defend against a single criminal prosecution, could not by themselves constitute irreparable damage in the special legal sense of the term.[38] Imaginary and speculative fears of state prosecution are also insufficient.[39] This language clearly rejects enjoining a criminal debtor's state prosecution for crime-related debt.

Because the debtor must demonstrate the existence of a "great and immediate danger," and that this danger is stronger than the presumption favoring denial, the average criminal debtor has little likelihood of enjoining the state criminal proceeding. An injunction, therefore, is not a likely solution.

B. Dischargeability and Nondischargeability of Criminal Debt

Another potential solution to the problem of criminal debt may be in the doctrine of dischargeability. Section 1328 of Title 11[40] states that *all* debts are dischargeable except for debts involving the curing of any default and support payments. Some courts, however, are finding criminal debts nondischargeable despite this broad dischargeability provision.

In *In re Jacobson,*[41] the bankruptcy court held that a fine imposed as a result of a criminal proceeding is not a debt contemplated by Chapter 13 and is therefore not dischargeable.[42] In *In re Newton,*[43] the bankruptcy court similarly held that an order for restitution is an integral part of the criminal proceeding against the debtor and is not dischargeable under the automatic stay provision of the Bankruptcy Code.[44] The court reasoned that in the absence of a federally-issued injunction, the Bankruptcy Code is applicable to a criminal debt. In supporting its decision, the court cited legislative history stating that "[t]he bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial overextension. Thus, criminal actions and proceedings may proceed in spite of bankruptcy."[45]

In *In re Vik,*[46] the bankruptcy court likewise held that a pre-bankruptcy restitution order arising out of a state criminal prosecution is not a "debt" within contemplation of federal bankruptcy laws and, as such, is not subject to discharge. Under the Bankruptcy Code, the term "debt" means liability on a claim,[47] and "claim" is defined as a right to payment.[48] A "creditor"

38. *Id.* at 46.
39. *Id.* at 42.
40. 11 U.S.C. § 1328.
41. 35 Bankr. 40 (Bankr. D. Ariz. 1983).
42. *Id.* at 41.
43. 15 Bankr. 708 (Bankr. N.D. Ga. 1981).
44. *Id.* at 710; 11 U.S.C. § 362.
45. *Newton,* 15 Bankr. at 710 (quoting S. REP. No. 989, 95th Cong., 2d Sess. 51-52 (1978)).
46. 45 Bankr. 64, 67 (Bankr. N.D. Iowa 1984).
47. 11 U.S.C. § 101(11).
48. 11 U.S.C. § 101(4).

is an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[49] Based on these definitions, the *Vik* court did not find that a state criminal restitution order creates a creditor-debtor relationship between either the debtor and the victim, or the debtor and the state, because neither the victim nor the state has a civil right to payment.[50] Likewise, the court in *In re Oslager*[51] held that an obligation to pay restitution is not a debt contemplated by the Bankruptcy Code and is therefore nondischargeable. Because restitution was of a rehabilitative nature, rather than an order to repay the victim, the court found there was no pre-existing debtor-creditor relationship.[52]

Proponents of the nondischargeable approach interpret section 101 to *exclude* criminal debts from the broad discharge provision in Chapter 13.[53] These courts do not define criminal restitution as a liability on a claim precisely because there is no civil right to payment. This view is based on the previously discussed principles of equity and comity militating against federal interference in state criminal proceedings,[54] and upon the policy of discouraging the use of bankruptcy courts as havens from the consequences of criminal acts. The very recent Supreme Court decision in *Kelly v. Robinson* supports this analysis regarding the dischargeability of criminal debt.[55] In *Robinson*, the Court declared that restitution obligations resulting from state criminal proceedings are not subject to discharge in Chapter 7 proceedings.

The opposing argument is that when a debtor avails herself of Chapter 13 in order to shed the burdens of otherwise nondischargeable debt, the debtor is merely taking advantage of an opportunity expressly granted to her by Congress.[56] Congress found a worthwhile purpose in granting a Chapter 13 discharge to all types of qualified debtors, "including embezzlers, murderers, rapists, forgers, thieves, arsonists and assorted other miscreants."[57] Courts, in applying this more liberal approach, adopt the theory of dischargeability of criminal debts, and find the language "all debts" in section 1328 to include criminal debts.[58] The language of the Bankruptcy Code supports the liberal approach discharging criminal debts. The Code defines "debt" as liability on a claim.[59] A "claim" is defined as a "right to payment whether or not

49. 11 U.S.C. § 101(9).
50. *Vik*, 45 Bankr. at 67.
51. 46 Bankr. 58 (Bankr. M.D. Pa. 1985).
52. *Id.* at 61, 62.
53. 11 U.S.C. § 101.
54. *Oslager*, 46 Bankr. at 62. *See supra* text accompanying notes 32-39.
55. 107 S. Ct. 353 (1986).
56. *In re* Chase, 28 Bankr. 814, 819 (Bankr. D. Md. 1983), *rev'd on other grounds*, 43 Bankr. 739 (Bankr. D. Md. 1983).
57. *Id.* at 819 n.3. *In re* DeSimone, 25 Bankr. 728 (Bankr. E.D. Pa. 1982), is a good example of Chapter 13's liberal discharge for criminals. In *DeSimone*, the bankrupt's debt resulting from an assault was held dischargeable as soon as practicable after completion of all payments under the plan. The discharge was granted despite the contention that the injury was willful and malicious.
58. 11 U.S.C. § 1328.
59. 11 U.S.C. § 101(11).

such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured . . . ."[60] The statute is broadly worded, presumably including criminal debt as a "claim," since Congress intended "claim" to be defined broadly, "contemplat[ing] that *all* legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case."[61] Although *Robinson* disagrees with this analysis, the Court refrained from holding that a criminal obligation is *not* a debt within the meaning of the Bankruptcy Code.[62] *Robinson* therefore merely stands for the proposition that criminal restitution is not subject to discharge in Chapter 7. The question remains whether criminal obligations are debts subject to discharge in Chapter 13.

If criminal restitution is a debt contemplated by the Code, it follows then that a criminal debt is dischargeable under Chapter 13 since *all* debts are dischargeable.[63] The unfortunate effect of such a statutory interpretation is to neutralize and render useless criminal restitution payments as a means of punishing criminal debtors. The convicted criminal will simply use bankruptcy to escape his obligation to make criminal restitution payments ordered by the court. This is the very harm sought to be avoided in the *Robinson* decision, however, application of this rationale in Chapter 13 would seriously jeopardize the overriding policy objective of "a complete settlement of the affairs of the bankrupt debtor, and a *complete discharge and fresh start.*"[64] Any policy of nondischargeability designed to eliminate the "criminal haven" also must comport with the goal of Chapter 13—a fresh financial start for the debtor who successfully completes his plan. When drafting the dischargeability provision of Chapter 13, Congress expressly omitted criminal debts from the list of nondischargeable exceptions because Congress intended that discharge in Chapter 13 be more generous than discharge in Chapter 7,[65] ensuring a fresh start for the successful Chapter 13 debtor. This fact suggests that the *Robinson* decision is logical only when applied to Chapter 7 cases. The effect of *Robinson,* however, may result in increasing use of Chapter 13 as a criminal haven because of its liberal discharge.

II. DEBT CLASSIFICATION: A POTENTIAL SOLUTION

Debt classification may provide an alternative solution to deciding whether criminal debts are or are not dischargeable. In general, classification of debts provides the debtor with flexibility to propose a plan which meets the

60. 11 U.S.C. § 101(4).

61. H.R. REP. No. 95, 95th Cong., 2d Sess. 309 (1979), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6266 (emphasis added).

62. *Robinson,* 107 S. Ct. at 631.

63. *All* debts are dischargeable except default and support payments. *See supra* note 8.

64. H.R. REP. No. 95, 95th Cong., 1st Sess. 1980 (1977), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6141, 6266 (emphasis added).

65. *DeSimone,* 25 Bankr. at 728.

requirements for confirming a plan, as set forth in 11 U.S.C. § 1322.[66] Classification also establishes a repayment program that is manageable for the debtor.[67] Debt classification closely relates to the general priority system of the Bankruptcy Act[68] and, in effect, creates priorities among holders of claims otherwise of the same class. Each claim within a class must be treated the same as every other claim within that same class. Treating claims differently thus creates different classes.[69]

Classifying the criminal debt claim separately from other claims increases the debtor's chances for success. The problems, however, of classifying criminal debt claims in Chapter 13 are ones of balancing competing policy considerations and of interpreting cryptic statutory language in deciding the status of a criminal restitution claim.[70] The Bankruptcy Code in section 1322 sets out three requirements for the classification of claims: (1) treatment provided must be the same for each claim within a class; (2) the designation of the class may not discriminate unfairly against any class so designated; and (3) a class may be only created as provided under section 1122.[71] Section 1122 specifies that a class may only be created where the claims comprising the class are "substantially similar,"[72] or are approved "as reasonable and necessary for administrative convenience."[73]

Chapter 13 requires identical treatment among "substantially similar claims," and discrimination is allowed only if it is fair. The courts tend to define these terms through exercises in statutory interpretation, rather than by the application of principles of equity. There is no consistent notion as to what is fair. There is, at best, a recognition that classification does involve discrimination and that not all "substantially similar" claims are required to be in the same class.[74]

If every classification discriminates, the question then centers upon which classifications discriminate unfairly. This "discriminates unfairly" test is unique to Chapter 13.[75] Whether a Chapter 13 debtor can classify a criminal debt separately from his other unsecured debts depends upon the court's interpretation of "unfair discrimination." In wrestling with the efforts of debtors to classify unsecured claims in order to satisfy Chapter 13 requirements, the courts have adopted significantly different interpretations of the

66. 11 U.S.C. § 1322 (1982 & Supp. III 1985).

67. *See generally* Vihon, *Classification of Unsecured Claims: Squaring a Circle?*, 55 AM. BANKR. L.J. 143 (1981).

68. 11 U.S.C. § 507.

69. Vihon, *supra* note 67, at 146.

70. Epstein, *Chapter 13: Its Operation, Its Statutory Requirements as to Payment to and Classification of Unsecured Claims, and Its Advantages*, 20 WASHBURN L.J. 1, 17 (1980).

71. 11 U.S.C. § 1322.

72. 11 U.S.C. § 1122(a).

73. 11 U.S.C. § 1122(b).

74. Vihon, *supra* note 67, at 174-75.

75. Epstein, *supra* note 70, at 14.

perceived meaning and intent of section 1322. The decisions cover the entire spectrum of possible views: at one end of the spectrum are opinions holding that *any* classification is per se inconsistent with the statutory proscription of no unfair discrimination;[76] at the other end is an opinion declaring that as long as a creditor would receive nothing in a Chapter 7 liquidation, there can be no unfair discrimination in separately classifying another creditor to receive more than the first creditor would receive.[77]

A. Criminal Debt Under the Current Classification Scheme

How criminal debts fare under the current classification scheme depends upon which of the two dominant viewpoints the court relies. The case of *In re Iacovoni,*[78] is illustrative of the most restrictive approach, which strictly interprets section 1122 of the Code[79] as saying that only if claims are "substantially similar" may they be classed together. In other words, only those debts which have identical legal rights may be classed together. Under *Iacovoni,* classification is based on the legal nature of the claim where all unsecured creditors have similar rights, absent some reason for equitable subordination.[80]

It is doubtful that criminal debts qualify for equitable subordination since the *Iacovoni* decision stressed that the direct tie between sections 1322 (b)(1) and 1122 reflects a legislative intent to adopt existing classification restrictions and to provide some protection to the unsecured Chapter 13 creditor.[81] Using the same strict statutory reasoning, the case of *In re Stewart*[82] declared that even a separate classification preferring child support over other unsecured debts violated the provisions of sections 1322 and 1122. Under the strict *Iacovoni* approach, therefore, a preferred classification of a criminal debt over other unsecured debts will be viewed as unfair discrimination between debts having identical legal rights.

The restrictive statutory approach to criminal debt classification greatly contrasts with the more realistic view that the degree of discrimination would

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76. *In re* Stewart, 13 Bankr. Ct. Dec. 458 (Bankr. W.D.N.Y. 1985); *In re* Newton, 15 Bankr. 708 (Bankr. N.D. Ga. 1981); *In re* Iacovoni, 2 Bankr. 256 (Bankr. D. Utah 1980).

77. The minority view, *In re* Sutherland, 3 Bankr. 420 (Bankr. W.D. Ark. 1980), rejected any sort of standard claiming that unfair discrimination cannot exist when the debtor is not obligated to pay the creditors any more than they would receive under Chapter 7. Where there would have been no distribution to unsecured creditors under Chapter 7, the unsecured creditors in Chapter 13 get nothing.

78. 2 Bankr. 256.

79. 11 U.S.C. § 1122.

80. *Iacovoni,* 2 Bankr. at 260.

81. *Id.* at 261. Unsecured Chapter 13 creditors need protection since they do not vote on a debtor's proposed Chapter 13 plan. Instead, the court confirms the plan if it meets certain legal criteria without regard to creditor acceptance or rejection of the plan. R. GINSBERG, *supra* note 1, at 1019.

82. 13 Bankr. Ct. Dec. 458.

be balanced with its justification. Under this more liberal view, each case is considered on the basis of its facts in determining whether the proposed classification unfairly discriminates against another class of claims.[83] This approach is more consistent with the Code's objective that Chapter 13 be a flexible vehicle for debt reorganization. Even more importantly, this approach is necessary if the allowance for classification in section 1322 is to have any meaning at all.[84]

One problem with the liberal approach is that courts are arriving at dramatically different conclusions by examining the individual facts of each case.[85] The case of *In re Hill*[86] held that certain classifications are appropriate among members of the same class as long as the claimants can be distinguished from one another. In this case, the District Court allowed the debtor to distinguish the claims of doctors and hospitals from the claims of lawyers, merchants and finance companies. The court ruled that such classification is justified when the debtor fears that he will not receive medical treatment in the future if his current medical debts are not paid in full.[87] In another case, *In re Chase,*[88] the court reasoned that Chapter 13 was purposely designed by Congress to be a method of discharging otherwise nondischargeable debts. As long as the debtor utilizes Chapter 13 in good faith and successfully completes his plan of repayment, his criminal debt will be discharged.[89]

Factors considered under the more liberal fact-sensitive approach include the debtor's reasons and good faith[90] in setting up the different classes; the creditors' rights against third parties; the importance of the classification to the debtor's fresh start; and the debtor's ability to perform under the plan.[91] Even the liberal opinions recognize, however, that allowing discriminatory classification without sufficient justification will encourage arbitrary and unfair discriminatory classifications by the debtors.[92] The ultimate inquiry

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83. *See In re* Moore, 31 Bankr. 12 (Bankr. D.S.C. 1983); Barnes v. Whelan, 689 F.2d 193 (D.C. Cir. 1982); *In re* Cook, 26 Bankr. 187 (D.C.N.M. 1982); *In re* Dziedzic, 9 Bankr. 424 (Bankr. S.D. Tex. 1981); *In re* Kovich, 4 Bankr. 403 (Bankr. W.D. Mich. 1980).

84. *Moore,* 31 Bankr. at 15; *Cook,* 26 Bankr. at 190.

85. *See generally In re* Haag, 3 Bankr. 649 (Bankr. D. Or. 1980); *In re* Curtis, 2 Bankr. 43 (Bankr. W.D. Mo. 1979).

86. 6 Bankr. Ct. Dec. 568 (Bankr. D. Kan. 1980).

87. *Id.* at 569.

88. 28 Bankr. 814 (Bankr. D. Md. 1983), *rev'd on other grounds,* 43 Bankr. 739 (Bankr. D. Md. 1984).

89. *Id.* at 819.

90. 11 U.S.C. § 1325(a)(3). This section requires that the Chapter 13 plan be proposed in good faith and not be forbidden by law. Non-payment to one class is not per se demonstration of bad faith. *In re* Rimgale, 669 F.2d 426 (7th Cir. 1982). "Exceptional circumstances" may warrant non-payment or lesser payment to a class where other policies dictate substantial payment to another class of unsecured creditors. *Cook,* 26 Bankr. at 191.

91. *Moore,* 31 Bankr. at 16-17.

92. *Id.* at 17; *Dziedzic,* 9 Bankr. at 427.

is whether the plan constitutes an abuse of the provisions, purpose, or spirit of Chapter 13.[93]

When confronted with discriminatory classification of criminal debt, the courts often are able to sidestep the difficult conflict of sending the debtor to jail unless he pays his criminal debt in full. The court in *In re Bowles*[94] concluded that the mere possibility of a state-imposed jail sentence did not adequately justify discrimination among unsecured creditors. The hypothetical nature of incarceration enabled the court to avoid addressing the inevitable situation of "pay or go to jail."[95] The same judicial reaction occurred in *In re Gay*[96] where the debtor's major justification for discrimination was that holders of short checks had the option of instituting criminal proceedings. The *Gay* court held that whether a criminal prosecution and possible jail sentence would impair the debtor's ability to pay was speculative.[97]

Relying solely upon the classification provisions of sections 1322 and 1122 clearly will not solve the problem raised by criminal debt in Chapter 13 proceedings. Under the more restrictive interpretation of the Code, the chance of separately classifying a criminal debt is minimal. Even under the most liberal approaches, the possibility of a separate classification is unclear. Judges inject their own personal philosophies into their Chapter 13 decisions which results in arbitrary injustices and inconsistency in the law. The great variety of interpretations hurts the very party which the Code was designed to help—the debtor. The debtor suffers not only because there is no uniform protection from state criminal prosecution, but also because the Code does not allow separate classifications of criminal debts from other unsecured debts.

B. A New Classification for Criminal Debt

Congress must clarify and resolve the problem with an amendment to section 1322 of the Code.[98] Such action is not unprecedented—in 1984 Congress added a special classification for unsecured claims involving both a bankrupt and a nonbankrupt as co-debtors.[99] The separate classification for criminal debt could be a synthesis of the entire conflicting Chapter 13

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93. *Chase,* 28 Bankr. at 817.
94. 48 Bankr. 502 (Bankr. E.D. Va. 1985).
95. *Id.* at 508.
96. 3 Bankr. 336 (Bankr. D. Colo. 1980).
97. *Id.* at 338.
98. 11 U.S.C. § 1322.
99. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 392 (1984). The amendment of 11 U.S.C. § 1322(b)(1) legislates a special class of unsecured claims where there is a co-debtor on a consumer debt. This legislation "shows that Congress, if it wants to, can exempt a debtor from the requirements of providing the same treatment to each claim of a particular class." *In re* Stewart, 13 Bankr. Ct. Dec. at 459.

policy considerations. This would reconcile the liberal discharge provisions with the overriding objective of a fresh financial start for the debtor, while also limiting the potential of Chapter 13 becoming a "haven for criminals."

Many cases implicitly support the idea of a separate classification for criminal debt.[100] These cases tend to define "good faith" liberally as a subjective concept. The bankruptcy court in *In re Seely*[101] remarked that "*good faith* is nowhere defined. . . . The term is broad, indefinite and of necessity tied to the facts of a specific case. . . . [I]t implies at least an honesty of purpose, that is, an actual intent to use the statutory process to effect a plane [sic] of reorganization."[102] Good faith thus does not turn on the amount of money paid by the debtor; interpreting the good faith requirement to mean some particular level of payment is required is unauthorized judicial legislation.[103] The recognition given to the importance of good faith strengthens the argument that as long as the criminal debtor's intent is honest, then the remainder of his criminal debts should be dischargeable upon successful completion of his Chapter 13 repayment plan.

The cases supporting the idea of a separate classification also read the statute quite literally, declaring that the Code is clear as to what debts are and are not dischargeable in a Chapter 13 case. The only exceptions to the dischargeability of all debts involve support payments and curing defaults.[104] The express language of the statute mandates the conclusion that every other debt is dischargeable.[105] The intent of Congress must be drawn from the language of the statute, unless that language is ambiguous.[106] Chapter 13 is not ambiguous in any respect, and the benefits granted are clearly stated. Most of these benefits are unavailable to a Chapter 7 debtor.[107] In their literal interpretation of the statute, these cases show due respect for the intent of Congress as written in the Code.

These cases actually suggest that if the public does not approve of the results of Chapter 13 it must push for legislative action.[108] Many courts are offended by the fact that a criminal debtor may obtain a discharge for debts under Chapter 13, which are nondischargeable under Chapter 7.[109] It is difficult, however, to find bad faith when a citizen avails himself of a legal remedy. Congress presumptively intended what it said; if Congress erred, it

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100. *See, e.g., In re* Brown, 39 Bankr. 820 (Bankr. M.D. Tenn. 1984); *Chase,* 28 Bankr. 814; *Cook,* 26 Bankr. 187; *Barnes,* 689 F.2d 193; *Dziedzic,* 9 Bankr. 424; *In re* Prine, 10 Bankr. 87 (Bankr. D. Idaho 1981); *In re* Seely, 6 Bankr. 309 (Bankr. E.D. Va. 1980).

101. 6 Bankr. 309.

102. *Id.* at 312.

103. *Prine,* 10 Bankr. at 89.

104. 11 U.S.C. §§ 1328, 1322(b)(5), 523(a)(5).

105. *Seely,* 6 Bankr. at 311.

106. *Prine,* 10 Bankr. at 89.

107. *Id.*

108. *See Chase,* 28 Bankr. 814; *Barnes,* 689 F.2d 193; *Prine,* 10 Bankr. 87; *Seely,* 6 Bankr. 309.

109. *Prine,* 10 Bankr. at 89.

is the duty of Congress to correct that error. This is a question of public policy which should be resolved by the legislature.[110] As Judge Bonney of the United States Bankruptcy Court in the Eastern District of Virginia aptly said:

> Does it not go against the grain with us to think that an embezzler, a fraud or a crook might find relief under Chapter 13? But it is not what goes against the grain that applies; it is what the law says.
>
> If the law is "wrong," it is the prerogative of Congress to change it and not we ourselves. We take a dim view of those tribunals which strain the law to reach a certain result or which would fashion their own personal values from the law.[111]

The solution is an express provision dealing with the problem of criminal debt classification. Once the intent of Congress is clearly expressed, the confusion resulting from the great variety of judicial interpretations will be eliminated. A separate classification will alleviate the tensions between the overriding purposes of Chapter 13 and the criticisms of overly liberal discharge provisions vis-a-vis criminal debt. The new provision could classify criminal debt separately while still keeping it dischargeable, thus protecting the Chapter 13 incentives of liberal discharge and promise of fresh financial start for the debtor.

A separate classification admittedly still allows bad debt proceedings to be brought by disgruntled creditors. The administrative costs of bringing suit will deter frivolous claims, but will have little effect on the prosecution of serious crimes such as embezzlement, misrepresentation and fraud. If the creditors can prove they were victims of a crime committed by the debtor, the creditors may benefit by receiving a higher percentage payout. The Chapter 13 plan itself, however, is not discouraged.

CONCLUSION

Chapter 13 is designed to rehabilitate the debtor in financial difficulty and, in essence, helps the debtor help himself. Although the liberal discharge provision and promise of a fresh financial start encourage the Chapter 13 debtor to successfully complete his plan, these incentives are undermined when some courts hold criminal debts nondischargeable. This nondischargeability forces the Chapter 13 debtor to pay his criminal debts in full or else go to jail. Other courts, by strictly interpreting the discharge provision, allow forgers, embezzlers and other criminals to avoid their obligations by discharging their criminal debts under Chapter 13.

The protections offered by the automatic stay provision do not apply to criminal actions against the debtor. Injunctions for relief from state criminal

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110. *Id.*

111. *Seely*, 6 Bankr. at 311 (footnote omitted) (paragraph order inverted).

proceedings are inadequate for several reasons: they pose a conflict between federal and state governments; they are available only where the danger is "great and immediate;" and finally, they are not a reliable source of protection for the criminal's statutory rights as granted by the Code.

A separate classification for criminal debt, carefully drafted to protect the purposes of Chapter 13, will prevent Chapter 13 from becoming a criminal haven. Such a classification can solve the criminal debt dilemma and avoid the policy conflict between federal and state governments, without allowing debtor manipulation by creditors, and without disrespect for the will of the legislature as expressed in codified law.

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