APPENDIX G-1.c

Discharge and Dischargeability in Consumer Bankruptcy Memorandum (Prepared by Hon. Samuel L. Bufford, Professor Margaret Howard, Professor Jeffrey W. Morris and Hon. Eugene R. Wedoff)

MEMORANDUM
May 30, 1997

TO: **National Bankruptcy Review Commission**

FROM: **Judge Samuel L. Bufford**
Professor Margaret Howard
Professor Jeffrey W. Morris
Judge Eugene R. Wedoff

RE: **Discharge and Dischargeability in Consumer Bankruptcy**

At the request of Professor Elizabeth Warren, we have reviewed various materials and discussed among ourselves many of the issues regarding dischargeability of debt in consumer bankruptcies, with the aim of presenting to the Commission a set of recommendations that can form the basis for discussion of this topic. After presenting an initial draft of recommendations to the Commission, we prepared the following revised discussion paper, reflecting various ideas raised at the Commission meeting. As before, we present our suggestions in two parts. First, we address the overall structure of dischargeability, recommending, with one change, retention of the current system. Second, we present a number of recommendations for specific change within that overall structure, set out according to the sections of the Bankruptcy Code dealing with consumer debt dischargeability, §§ 523, 727, and 1328.

A. Structure of consumer debt dischargeability.

1. Retain the current framework.

Current bankruptcy law provides two different methods by which individual debtors may discharge their indebtedness—(1) in Chapter 7, by surrendering their nonexempt assets as of the time of bankruptcy filing, or (2) in Chapter 13, by paying their disposable income for a three to five year period after bankruptcy filing. Chapter 13 is encouraged, but not required. Within this two-chapter framework, the starting principle is that all prepetition debt is discharged (see § 727(b)), but that discharge may be denied or limited. In Chapter 7, discharge may be denied entirely, pursuant to § 727(a), on a number of substantive grounds, most of which involve debtor misconduct threatening the integrity of the bankruptcy system. Chapter 13 has no provision for a complete denial of discharge, but conduct threatening the integrity of the bankruptcy system has been held to constitute grounds for dismissal of the case. *See, e.g., In re Love*, 957 F.2d 1350, 1357-58 (7th Cir. 1992) (Chapter 13 case dismissed for lack of good faith because debtor/tax protester filed false schedules in an effort to avoid paying tax debt).

In addition to a general denial of discharge, current law provides that particular kinds of debts may be excepted from the discharge otherwise granted. The type of debt excepted from discharge again depends on which chapter of the Bankruptcy Code is involved. One class of

debt—Chapter 7 nondischargeable debt—is excepted from discharge in Chapter 7, but remains dischargeable in Chapter 13. Debt in this category involves culpable conduct by the debtor. Examples of Chapter 7 nondischargeable debt include debts arising from fraud (§ 523(a)(2)), intentional torts (§ 523(a)(6)) and noncompensatory civil penalties (§ 523(a)(7)). Because such culpably incurred debts may be discharged through a Chapter 13 plan, Chapter 13 is said to offer a ?superdischarge." Certain types of Chapter 7 nondischargeable debt, frequently litigated, may only be adjudicated in bankruptcy court, pursuant to § 523(c).

A second class of debt—Chapter 13 nondischargeable debt—is excepted from discharge in both Chapter 7 and Chapter 13 cases. Debts in this class arise from obligations that are seen as absolutely requiring payment for the good of society, regardless of whether they were incurred culpably. Such debts, including some tax and all family support obligations, are never discharged in bankruptcy, and are (or should be) paid on a priority basis, ahead of other unsecured claims.

We recommend retaining this two-tiered system of dischargeability. It is certainly appropriate to except from any bankruptcy discharge debts whose payment is societally essential and, thus, Chapter 13 nondischargeable debt is required. But if payment of a debt is not required for the good of society, then, even though the debt was incurred culpably, it is appropriate—for several reasons—to allow the debt to be discharged in Chapter 13 and excepted from discharge only in Chapter 7.

First, exception from discharge in Chapter 7 is itself a significant sanction for culpable conduct. In Chapter 7, an individual is given an immediate discharge of all indebtedness in exchange for the surrender of nonexempt assets. If the individual owns few assets, no property at all may be surrendered. In contrast, a debtor in Chapter 13 is required to pay creditors all of his or her disposable income for a period of at least three years, subject to the supervision of a trustee—a substantial, disciplined undertaking that can teach a debtor financial responsibility.

Second, the possibility of discharge in Chapter 13 provides an opportunity for a fresh start to a debtor who has engaged in culpable conduct. A major premise of bankruptcy in general is that individuals burdened with debt should have an opportunity to return to economic freedom in a reasonable period of time, since the pressure of paying debt discourages individuals from advancing themselves and their families. While not condoning bad behavior, Chapter 13 allows for it to be ?worked off" over three to five years, thus giving hope to debtors who honestly want to deal with culpably incurred debt.

Third, the possibility of discharging culpably incurred debt in Chapter 13 encourages ratable distribution of the debtor's disposable income. If culpably incurred debt cannot be discharged in Chapter 13, an individual who has incurred such debt and requires bankruptcy relief has a substantial incentive to file under Chapter 7 rather than Chapter 13. In Chapter 7, the debtor would be given an immediate discharge of other debts (which would often be paid nothing), and the debtor's entire postpetition disposable income could be devoted to paying the culpably incurred debt. In Chapter 13, on the other hand, postpetition disposable income could not be used to pay only culpably incurred debt. Rather, the income would be distributed pro rata

to all creditors, and so, at the end of the plan, the debtor could owe far more of the culpably incurred debt than if he or she had filed a Chapter 7 case. If culpably incurred debt remains dischargeable in Chapter 13, the debtor has an incentive to file under that chapter, and thus to make payments from postpetition disposable income to all creditors, pro rata.

Fourth, dischargeability of culpably incurred debt in Chapter 13 avoids litigation. If debts connected with culpable conduct are nondischargeable in Chapter 13, questions of culpability will need to be litigated far more frequently. Administrative costs will increase and distributions to creditors as a whole will decrease.

2. § 109(e): the limit on the amount of unsecured debt that can be discharged in Chapter 13 should include unliquidated debt.

The major argument against discharge of culpably incurred debt in Chapter 13 is that it can allow debtors who have engaged in egregious conduct—homicide, sexual assault, large-scale investment fraud, and the like—to escape the financial consequences of their conduct. This concern is largely misplaced, due to the eligibility requirements for Chapter 13. Section 109(e) of the Bankruptcy Code provides that, in order to be a debtor under Chapter 13, an individual must owe ?noncontingent, liquidated, unsecured debts of less than $250,000" on the date of filing. Thus, any debtor whose misconduct has resulted in debts of $250,000 or more is automatically excluded from Chapter 13 relief. Most situations of truly egregious conduct are thus denied discharge in Chapter 13.

In one circumstance under current law, however, a debtor who has engaged in egregious conduct may obtain a Chapter 13 discharge—that is, if the claim against the debtor has not been liquidated prior to the bankruptcy filing. We recommend that this situation be addressed by amending § 109(e) to remove the provision that the $250,000 limit be of ?liquidated" debts. Thus, if a debtor is subject to unliquidated claims arising out of egregious conduct, the court may hold a hearing to estimate the value of the claims. If they (together with other unsecured claims against the debtor) exceed $250,000, the case will be dismissed or converted to Chapter 7.

This recommendation is appropriate wholly apart from considerations of egregious misconduct. The ?liquidated claim" requirement of current law provides an incentive to file bankruptcy cases prematurely. Individuals subject to claims that may exceed the unsecured debt limitation have an incentive under current law to file a Chapter 13 bankruptcy before those claims can be adjudicated in state court. The eligibility of a debtor for Chapter 13 relief should not vary according to the fortuity of when claims against the debtor are liquidated.

B. Specific recommendations.

Retaining the two-tiered system of dischargeability, as we suggest above, has the advantage of continuing provisions of law affecting consumer debt discharge that are operating effectively; it also provides a grounding for recommendations for change. We make the following suggestions with the understanding that (1) discharge should generally be allowed; (2) denial of the Chapter 7 discharge should be available in response to debtor misconduct that threatens the integrity of the bankruptcy system; (3) particular debts incurred through culpable conduct should be nondischargeable in Chapter 7, but should continue to be dischargeable in Chapter 13; (4) debts required to be paid for the general good of society should continue to be nondischargeable in either Chapter 7 or Chapter 13; and (5) exceptions to discharge should not be enacted if they deal only with discrete types of claims faced by specific creditors and lack sufficient justification in fundamental bankruptcy policy.

1. § 523(a)(1): not addressed.

Section 523(a)(1) deals with the nondischargeability of taxes in Chapter 7. The ABA Task Force on Taxation and Bankruptcy has reviewed these issues in some detail. Given the scope of our review of the Bankruptcy Code's discharge and dischargeability provisions, we defer to that group's report. We address the application of § 523(a)(14) later in this report, however.

2. § 523(a)(2): remove credit card indebtedness and treat it in a separate section, under which dischargeability would be determined without reference to fraud.

Section 523(a)(2) excepts from Chapter 7 discharge debts arising from fraud, in three subparagraphs:

- § 523(a)(2)(A) deals with fraud not based on a written statement involving the debtor's financial condition;
- § 523(a)(2)(B) deals with fraud that does involve a written representation of the debtor's financial condition; and
- § 523(a)(2)(C) creates a presumption that certain credit card debt incurred shortly before the filing of a bankruptcy case is nondischargeable under subparagraph (2)(A).

Except as applied to credit card debt, § 523(a)(2) does not present substantial difficulties in application, particularly after the clarification of the intent requirement provided by the Supreme Court in *Field v. Mans*, 116 S.Ct. 437, 446, 133 L.Ed.2d 351 (1995). As applied to ordinary situations of fraud—involving some representation by the debtor directly to a creditor—the first two subparagraphs of § 523(a)(2) need no amendment. Thus, § 523(a)(2) should continue to apply to fraud in an *application* for a credit card. The concept of fraud as applied to credit card *use*, however, presents substantial problems, reflected in a wide range of conflicting judicial opinions differing on questions such as the nature of the representation the debtor makes in using

a credit card and the extent to which a credit card issuer needs to show reliance on such a representation. We suggest dealing with credit card use in a separate paragraph of § 523, not based on fraud. Accordingly, § 523(a)(2)(C) should provide simply that § 523(a)(2) does not apply to any claim of a credit card issuer against the card holder arising out of the card's use. The new provisions we suggest to deal with this situation are described below.

3. § 523(a): add a new subparagraph providing that credit card debt incurred by the debtor with an intent not to repay is nondischargeable, but only if the credit card issuer has been reasonably diligent.

Courts have differed on the question of what use of a credit card give rises to Chapter 7 nondischargeability. Some courts, including *Anastas v. American Savings Bank (In re Anastas)*, 94 F.3d 1280, 1285 (9th Cir. 1996), have held credit card debt nondischargeable if the debtor incurred the debt intending not to repay it—that is, deliberately used the charge card with the intent of avoiding the resulting claim, through bankruptcy or otherwise. Other courts have found nondischargeability in a second situation—when the debtor used the card under circumstances indicating that the debtor would not likely be able to repay the debt, even if the debtor did have an actual intent to repay. *See, e.g., Chase Manhattan Bank v. Sparks (In re Sparks)*, 154 B.R. 766 (N.D.Ala. 1993). We do not believe that this second situation should give rise to nondischargeability. Bankruptcy relief has traditionally been available to individuals who incur credit unwisely, undertaking larger obligations than they could reasonably have expected to repay, and there is no reason why credit card debt should be treated differently. Rather, unwise incurring of credit should challenge credit issuers to be more circumspect in lending. Our conclusion is buttressed by the fact that credit card issuers appear to promote use of the card beyond the cardholders' ability to make prompt repayment. Cardholders are often encouraged to maintain large balances (for example, by raising credit limits in response to the cardholders' exceeding the established limit), and are encouraged to make small payments (by low minimums and invitations to "skip a month").

On the other hand, we believe that debtors who deliberately incur credit card debt intending not to repay it are acting culpably and that the resulting debt should be nondischargeable, as long as the credit card issuer acted responsibly in extending credit. Accordingly, we make the following suggestions for the general nondischargeability of debt resulting from credit card use:

(a) As an element of a nondischargeability claim for the debtor's use of a credit card, the credit card issuer must establish that it has monitored the debtor's account no less than on an annual basis, and in that monitoring obtained information from the debtor regarding the debtor's current income and obtained information from a credit reporting service regarding the debtor's total indebtedness. No other showing of reliance would be required.

(b) The credit card issuer must further establish that the debtor incurred the credit card debt in question with an intent not to repay the debt. This intent will be presumed with respect to (a) any charge made within 90 days of the filing of the bankruptcy case for goods or services not

necessary for the support of the debtor or a dependent of the debtor, and (b) any cash advance taken by the debtor within 90 days of the filing of the bankruptcy case.

(c) The debtor may establish as an affirmative defense that (i) information available to the creditor in the annual monitoring demonstrated that the debtor would not be able to repay the outstanding credit card indebtedness with the debtor's current income, (ii) the creditor failed to take action to prevent further extensions of credit to the debtor, and (iii) such action would have prevented the charges in question from having been incurred.

(d) This paragraph would not apply to credit card debt incurred for purposes of gambling. That situation would be addressed by another separate provision, discussed below.

In order for this provision to be administered fairly, it is essential to assure debtors and their counsel that reasonable attorney's fees will be awarded if the debtor prevails in an action under this provision. In the absence of such assurance, debtors will have an incentive to agree to make payments to credit card issuers simply to avoid the expenses of defense.

Disputes regarding dischargeability of debts arising from the use of credit cards should remain within the exclusive jurisdiction of the bankruptcy court, and thus the new provision recommended here should be included within § 523(c).

4. § 523(a): add a new subparagraph providing that credit card debt incurred by the debtor for purposes of gambling is nondischargeable, but only if the credit card issuer has been reasonably diligent and if the credit card transaction did not take place at or near a gambling operation.

Gambling debts present a distinct subcategory of credit card debt. Like other credit card debt, they raise the question of the extent to which creditors should be required to show reasonable efforts to monitor the debtor's economic condition as a prerequisite to obtaining a judgment of nondischargeability. We have separately addressed that issue, requiring diligence by credit card issuers as a prerequisite for a claim of nondischargeability. Those same requirements of diligence should be applicable to the nondischargeability of gambling debts.

The idiosyncrasy of gambling debts lies in the nature of the debtor's intent. As discussed above, we believe that a debtor's incurring of credit card debt is subject to Chapter 7 nondischargeability if the debtor intends not to repay the debt. The reason gambling debts are unique in this context is that it may never be possible to demonstrate an intent not to repay, since debtors may always argue (and believe) that they intended repayment from their expected winnings. We believe, however, that debtors act culpably when they incur credit card debt that can only be repaid from gambling winnings. Recognizing that gambling is frequently an addictive behavior, Chapter 7 nondischargeability of gambling debts incurred in excess of ability to repay is nevertheless appropriate, both as a message that the conduct is undesirable and as an incentive to rehabilitation through Chapter 13, in which the debtor's budget and expenditures will be subject to monitoring.

At the same time, we believe that the location of automatic teller machines on or near the premises of gambling operations presents temptations to credit abuse that should not be supported by the Bankruptcy Code. Accordingly, we recommend an exception to nondischargeability for any credit card cash advance obtained at or within one-half mile of a gambling operation and used for gambling. (This limitation would not discourage placement of automatic teller machines in the vicinity of gambling operations; it would simply discourage those automatic teller machines from dispensing cash advances on credit cards. Cash withdrawals from bank accounts would not be affected.)

Accordingly, the new provision for nondischargeability of credit card gambling debts would be as follows:

(a) The credit card issuer must establish that it has monitored the debtor's account no less than on an annual basis, and in that monitoring obtained information from the debtor regarding current income and obtained information from a credit reporting service regarding the debtor's total indebtedness. No other showing of reliance would be required.

(b) The credit card issuer must further establish that the debtor incurred the credit card debt in question at a location more than one-half mile from a gambling operation, for the purposes of gambling, and that, at the time the debt was incurred, the debtor had no reasonable ability to repay it except from gambling winnings.

(c) The debtor may establish as an affirmative defense that (i) information available to the creditor in the annual monitoring demonstrated that the debtor would not be able to repay the outstanding credit card indebtedness with the debtor's current income, (ii) the creditor failed to take action to prevent further extensions of credit to the debtor, and (iii) such action would have prevented the charges in question from having been incurred.

Disputes regarding dischargeability of debts arising from the use of a credit card to finance gambling should remain within the exclusive jurisdiction of the bankruptcy court, and thus the new provision recommended here should be included within § 523(c).

5. § 523(a)(3): limit the amount of nondischargeable debt to the actual loss caused by lack of notice of a bankruptcy.

Section 523(a)(3) deals with situations in which the debtor fails to schedule a creditor and the creditor lacks timely notice of bankruptcy. Two different problems of this sort are addressed. Section 523(a)(3)(B) deals with claims excepted from discharge that are within the exclusive jurisdiction of the bankruptcy court, pursuant to § 523(c). If a creditor holding such a claim does not receive notice of the bankruptcy in time to file a dischargeability complaint in bankruptcy court, § 523(a)(3)(B) provides that the debt is nondischargeable in Chapter 7. The only change needed here is to include claims under § 523(a)(15) within the coverage of § 523(a)(3)(B), if these claims remain within the bankruptcy court's exclusive jurisdiction. (As noted below, we recommend elimination of § 523(a)(15).)

Section 523(a)(3)(A) deals with creditors who receive notice of bankruptcy too late to file a timely claim. This provision has caused difficulty in application whenever a creditor is omitted from the schedules in a case without assets to distribute. In such no-asset cases, creditors need not file claims; hence, some courts have found that § 523(a)(3)(A) never comes into effect and the unscheduled debts are discharged. *See, e.g., In re Mendiola*, 99 B.R. 864, 867 (Bankr.N.D.Ill. 1989). Other courts have held that it is necessary to amend the debtor's schedules to include the omitted creditor in order for the claim to be discharged, and that if leave to amend is denied, the debt is nondischargeable in Chapter 7. *See, e.g., In re Faden*, 96 F.3d 792, 796-97 (5th Cir. 1996). We recommend that § 523(a)(3)(A) be amended to make it clear that the section creates a nondischargeable debt only to the extent that a creditor is harmed by an inability to file a timely proof of claim. Section 523(a)(3)(A) would be inapplicable in no-asset cases, therefore, since filing a proof of claim would not result in any distribution to a creditor. The result in *Faden* would be overruled. Moreover, even when there are assets to be distributed, the creditor should have a nondischargeable debt only in the amount of the distribution it would have received if it had been able to file a timely claim, together with interest from the date of distribution. Otherwise, the nondischargeable debt may exceed the loss caused to the creditor. For example, debtors with a total estate of only $10,000 might negligently omit a personal injury claim that is ultimately valued at $500,000. Nothing justifies awarding a nondischargeable claim of $500,000 to the creditor, who would have received less than $10,000 had it been able to file a timely proof of claim.

6. § 523(a)(4): limit to negligence with respect to property held under an express trust or pursuant to a fiduciary relationship.

Section 523(a)(4) currently provides Chapter 7 nondischargeability for debts arising from **?**fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." This language is redundant of other exceptions to discharge and contains ambiguities that should be clarified.

The redundancies relate to fraud, embezzlement and larceny. Debts arising from fraud are dealt with by § 523(a)(2), and a separate provision regarding fraud while acting in a fiduciary capacity is unnecessary. The Supreme Court made clear in *Field v. Mans*, 116 S.Ct. 437, 443, 133 L.Ed.2d 351 (1995), that § 523(a)(2)(A) incorporates the common law understanding of fraud, and this understanding is fully applicable to fraud by fiduciaries. Embezzlement and larceny are both intentional torts respecting property. *See Transamerica Commercial Fin. Corp. v. Littleton*, 942 F.2d 551, 555 (9th Cir.1991) (defining ?embezzlement” as a fraudulent misappropriation of property by someone who lawfully obtained possession of the property); *Kay v. Rose (In re Rose)*, 934 F.2d 901, 903 (7th Cir.1991) (defining ?larceny” as wrongfully taking the property of another with fraudulent intent). As with other intentional torts respecting property, larceny and embezzlement are already incorporated within § 523(a)(6), as discussed below. *See Printy v. Dean Witter Reynolds, Inc.*, 110 F.3d 853, 858 (1st Cir. 1997) (conversion included within the scope of § 523(a)(6)). Section 523(a)(4) contains only one provision not duplicative of other subparagraphs of § 523(a)—the provision regarding defalcation in a fiduciary capacity. We recommend that § 523(a)(4) be limited to this provision so that its scope can be clearly defined.

?Defalcation” is generally defined as failure by a fiduciary to account for property held in trust. *See, e.g., Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir. 1993) (?‹defalcation’ refers to a failure to produce funds entrusted to a fiduciary.”). The defalcation provision of § 523(a)(4) presents two distinct ambiguities, however: first, the mental state that is required, and second, the scope of the trusts to which it applies.

Courts are divided as to the intent that must accompany a failure to account, in order for a defalcation to have taken place. Some decisions require intentional misconduct, others negligence, and some state that even innocent failures to account may give rise to liability for defalcation. *See Meyer v. Rigdon*, 36 F.3d 1375, 1382-85 (7th Cir.1994) (collecting and discussing the conflicting decisions). We recommend that a negligence standard be adopted for defalcations under § 523(a)(4). On one hand, the general policy of Chapter 7 nondischargeability is that personal culpability be involved. Thus, it would not be appropriate to make nondischargeable a purely innocent failure to account for trust property (as when property was stolen despite reasonable safeguards by the trustee). On the other hand, trustees have traditionally been held to a higher standard than other persons dealing with property. See *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928), in which Justice Cardozo made the famous remark that the standard of behavior for a trustee is ?the punctilio of an honor the most sensitive.” Given this traditional standard of behavior, neither is it appropriate to require that the trustee have intentionally or recklessly dealt with trust property before a failure to account gives rise to a nondischargeable debt. Instead, we suggest that a trustee be held to a standard of negligence, --that is, the trustee should be required to take at least reasonable care to protect trust property. If the trustee fails to do so and the trust property is lost, the resulting debt should be nondischargeable in Chapter 7..

The next ambiguity concerns the nature of the ?trusts” as to which duties may be enforced under § 523(a)(4). As outlined in *In re Marchiando*, 13 F.3d 1111, 1115-16 (7th Cir. 1994),

§ 523(a)(4) might apply to at least four different situations: (1) formal trusts, in which a settlor creates a res under the control of a trustee, with named beneficiaries; (2) relationships that do not involve formal trusts, but in which one party reposes such special trust or confidence in another that the high standards of behavior applicable to formal trusts have been applied, such as the attorney/client relationship; (3) situations in which statutes or financing documents have imposed the duties of trustee on what would otherwise be a debtor-creditor relationship; and (4) situations in which the law has used concepts related to trusts in fashioning remedies, as with constructive trusts imposed as a remedy for misconduct or resulting trusts imposed to effectuate the actual intent of a transferor. (See *Georgia Pac. Corp. v. Sigma Service Corp*., 712 F.2d 962, 968 n.4 (5th Cir. 1983), for definitions of constructive and resulting trusts.) Decisions applying § 523(a)(4) have uniformly held that formal trusts are within its scope and that constructive and resulting trusts are not. As discussed in *Marchiando*, however, decisions disagree about application of the provision to fiduciary duties and trusts created by statute.

We recommend a narrow scope for trusts to which § 523(a)(4) applies, limited to (1) formal trusts and (2) property held by the debtor for the benefit of a person who has reposed special trust or confidence in the debtor. In these two situations, a debtor should be aware of the importance of exercising care over trust property; negligence in doing so is sufficiently culpable to call for Chapter 7 nondischargeability. On the other hand, mere negligence in carrying out duties imposed by statute or financing documents does not imply such culpability. We believe that nondischargeability in connection with secured credit and statutory duties should be limited to intentional misconduct, as otherwise provided in § 523(a).

To summarize, then, we propose that § 523(a)(4) be amended to provide for Chapter 7 nondischargeability only when a debt arises from the debtor's failure to exercise reasonable care over property that is subject to a formal trust or that was held by the debtor for the benefit of a person who reposed special trust or confidence in the debtor.

7. §523(a)(5): incorporate § 523(a)(18).

Section 523(a)(5) makes obligations for support, maintenance and alimony nondischargeable. This is part of an overarching bankruptcy policy that we recommend leaving intact. It is generally accepted that family support obligations are of critical societal importance. When these obligations are not honored, the people requiring support may suffer catastrophic consequences and may ultimately need governmental assistance to make up for the lack of support. The Bankruptcy Code, as originally enacted, recognized the societal importance of support payments by excluding them from discharge in both Chapter 7 and Chapter 13 cases. 11 U.S.C. §§ 523(a)(5), 1328(a). The Bankruptcy Reform Act of 1994 further advanced the policy of requiring payment of support obligations by according them priority in payment over other unsecured claims. 11 U.S.C. § 507(a)(7).

According to the legislative history, federal law governs whether an obligation is in the nature of support and courts determining the issue are not bound by the description of the obligation used in a particular divorce decree or settlement. H.R.Rep. No. 595, 95th Cong. 1st

Sess. 364 (1977) ("What constitutes alimony, maintenance, or support, will be determined under the bankruptcy laws, not State law."); S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978) (same). Thus, an obligation described as a property settlement is nevertheless nondischargeable under § 523(a)(5) if the obligation is actually in the nature of support. *See, e.g., Williams v. Williams (In re Williams)*, 703 F.2d 1055, 1057 (8th Cir. 1983). This state of the law, then, requires that actual support obligations, regardless of how they are characterized, be treated as nondischargeable in bankruptcy.

Under §§ 523(a)(5) and 1328(a)(2), support obligations are Chapter 13 nondischargeable debt, and we believe that this is appropriate. There may be no personal culpability in the debtor's incurring of the debt (for example, the debtor may have suffered a loss of a job or a serious medical problem making it impossible to pay the support as it became due). Nevertheless, because of the societal need for support obligations to be paid, discharge of the debt is always denied.

Because we believe that the dischargeability and priority provisions regarding family support obligations are appropriate, we believe that support obligations owed to a state or municipality (as may result from the state or municipality having incurred costs due to nonpayment of support), should also be nondischargeable in Chapter 13. The nondischargeability of support obligations owed to states and municipalities is currently set out in § 523(a)(18). Section 523(a)(18) only creates Chapter 7 nondischargeability. Placing its provisions into § 523(a)(5) would make the Code clearer and would also make the provisions of § 523(a)(18) nondischargeable in Chapter 13, since Chapter 13 nondischargeable debt, as defined by § 1328(a), includes § 523(a)(5).

8. § 523(a)(6): define scope and nature of intent; remove nondischargeability for transfer of property subject to liens.

Section 523(a)(6) bars the discharge of debts for willful and malicious injury to another's person or property. We recommend that three changes be made to this provision:

First, the scope of § 523(a)(6) should be more clearly defined. Because fraud is already covered by § 523(a)(2), inclusion of fraud within § 523(a)(6) is unnecessarily duplicative; the provision should be amended to exclude it. This would have the benefit of requiring consistent proof of fraud, whether it involves injury to a person or property. The principal distinction between treatment of fraud under §§ 523(a)(2) and 523(a)(6) has been the availability of punitive damages, with some courts holding such damages not available under § 523(a)(2). *See Rubin v. West (In re Rubin)*, 875 F.2d 755, 758 n.1 (9th Cir. 1989) (discussing authorities). We propose to eliminate this distinction by adding to § 523(a)(7) a new provision that all punitive damages awarded against a debtor are nondischargeable in Chapter 7. See the discussion of § 523(a)(7), below. Thus, fraud claims should be expressly omitted from the scope of § 523(a)(6). On the other hand, embezzlement and larceny are intentional torts resulting in harm to property; thus they should be expressly included within § 523(a)(6), rather than in § 523(a)(4). As discussed above, § 523(a)(4)is more appropriately limited to negligence in dealing with trust property.

Second, we recommend that the mental state required for nondischargeability under § 523(a)(6) be clarified. One of the most difficult interpretive problems under § 523(a)(6) involves behavior by the debtor that cannot be described as intentional, but is extremely reckless. The issue in such cases is whether the provision applies only when the debtor intends to hurt someone, or whether it is sufficient if the debtor takes an intentional action that is highly likely to, and does, hurt someone. The difficulty in dealing with this issue is reflected in the recent en banc decision of the Eighth Circuit in *Geiger v. Kawaauhau (In re Geiger)*, 1997 WL 244756 (8th Cir. 1997), which held, over a vigorous dissent, that medical malpractice virtually certain to cause injury did not give rise to a nondischargeable debt under § 523(a)(6). As in *Geiger*, courts have struggled to reach appropriate results when debtors—without specifically intending injury—take extremely reckless or potentially dangerous actions that are likely to cause injury, and do in fact cause injury. Some courts have held the resulting claims dischargeable on the grounds that § 523(a)(6) requires a specific intent to injure; others have held the resulting claims nondischargeable, finding that the intent to take such an action suffices under § 523(a)(6).

We believe that Chapter 7 nondischargeability in these cases should not be limited to situations in which the debtor intended to cause the particular injury that actually occurred. Instead, we recommend that § 523(a)(6) be amended to provide that conduct causing injury results in nondischargeability if (1) the debtor intentionally took the action and (2) the debtor was aware of facts that would have led a reasonable person to know that injury is highly likely to result from that action. The operation of this standard can be illustrated by the facts of the famous *Hartley* case, 869 F.2d 394 (8th Cir. 1989). In that case, the debtor-employer sent his employee into a poorly-ventilated basement to clean tires with a gasoline mixture and then, after fumes had collected, threw a firecracker into the basement to ?startle" the employee. The resulting claim would not be dischargeable under the recommended standard, because the employer was aware of facts (the use of gasoline in an enclosed area) that would have led a reasonable person to know that the firecracker would cause injury. If the employer had not been aware that the employee was using gasoline in the basement, however, the claim arising from injury would be dischargeable.

Third, we recommend that conversion of consumer goods subject to security interests be treated separately, as discussed in the following paragraph. Transfers of commercial collateral would not be affected by the new provision. Similarly, if a debtor intentionally transfers property that the debtor does not own, the resulting conversion claim would continue to be nondischargeable under § 523(a)(6).

9. §523(a): add a new subparagraph providing for nondischargeability of certain transfers of consumer goods subject to security interests.

We believe that a debtor's transfer of consumer goods subject to security interests should be treated separately from intentional torts. The problem with such conversion claims is that consumers are frequently unaware that the property at issue was subject to a security interest. Transferring such property, whether by gift, sale or abandonment, does not involve the kind of personal culpability that should result in an exception from discharge. On the other hand, when debtors are likely to be aware that they are harming the interests of a secured creditor by transferring consumer goods, Chapter 7 nondischargeability is appropriate. Accordingly, we make the following recommendations.

(1) Nonpurchase money security interests. Nondischargeability should not result from the transfer of household goods subject to a nonpurchase money security interest. Property essential for ordinary living purposes (basic furniture, clothing and appliances) is not likely to be the basis for genuine nonpurchase money security interests. This property has little resale value and transfer is most often through a garage sale, a gift or an abandonment. Such transfers are not culpable. By ?household goods" in this context, however, we do not mean to include all property that might be found in a household. Rather, we mean basic living necessities. For purposes of this provision, household goods should be defined pursuant to 16 C.F.R. § 444.1(i), a regulation of the Federal Trade Commission defining household goods more narrowly than the understanding reflected in §§ 522 and 722. Thus, the protection available to debtors under this provision should not reach artworks, jewelry or similar items that frequently have both significant and appreciating value, and so might genuinely serve as collateral for nonpurchase money loans.

(2) Purchase money security interests. Some retailers purport to take security interests in all consumer goods they sell, even when they advertise the goods for purchase as gifts, often placing language creating the security interest in fine print on a charge slip. By the time of the bankruptcy filing, these goods are also "garage sale" items and may have been discarded by the debtor. Goods involved in these purchases frequently are inexpensive even at the outset: they may include sheets, towels, kitchen knives and coffee cups. We recommend that transfers of consumer items subject to purchase money security interests result in nondischargeable debt only if two conditions are met:

• First, a separate security agreement for the particular item in question must have been signed by the purchaser, stating prominently, above the signature, that the seller is retaining a security interest in the property and that the purchaser may not sell or otherwise transfer the property until full payment has been made. This requirement is intended to prevent nondischargeability arising from security agreements of which the debtor is unaware.

• Second, a claim for nondischargeability should be maintainable only for property of substantial value: we recommend that the statute set a floor of $500 purchase price for each such item of consumer goods (which would be adjusted periodically pursuant to § 104(b)). The

amount of the nondischargeable debt would continue to be limited to the value of the collateral at the time of transfer by the debtor, however.

Disputes regarding dischargeability of debts arising from the transfer of consumer goods subject to security interests should remain within the exclusive jurisdiction of the bankruptcy court, and thus the new provision recommended here should be included within § 523(c).

10. § 523(a)(7): include punitive damages.

Section 523(a)(7) creates a category of Chapter 7 nondischargeability for noncompensatory fines and penalties. This provision has created no substantial difficulty in application and is appropriate: conduct giving rise to fines and penalties is sufficiently culpable to require payment of the resulting debt or completion of a Chapter 13 plan. We recommend no change in this respect. We believe, however, that § 523(a)(7) should be expanded to include awards of punitive damages against debtors. Punitive damages, just like noncompensatory fines and penalties, are imposed to deter significant misconduct. By providing that such damages are generally nondischargeable, § 523(a)(7) would avoid disputes as to whether punitive damages are included in the debts excepted from discharge under other subparagraphs of § 523(a).

11. § 523(a)(8): limit to HEAL loans; or, alternatively, reduce the period of nondischargeability to five years following the date that the loan first becomes due.

The debtor's primary purpose for seeking bankruptcy relief is to obtain a discharge of debts. The Bankruptcy Code recognizes this as one of its most fundamental purposes and it makes discharge available to most individual debtors. While § 727 places some limitations on the availability of discharge, these limitations are both appropriate and relatively rarely invoked. Section 523 acts in concert with § 727 and excepts a number of specific obligations from the effects of the bankruptcy discharge. Thus, § 523 deviates from the norm generally recognizing that debtors need a discharge of their debts through the bankruptcy process.

Notwithstanding the general availability of the discharge, § 523(a) provides that certain debts should pass through bankruptcy unaffected by discharge. Debts created by the debtor's intentionally wrongful conduct are excepted from discharge to ensure that the debtor does not benefit from those actions. Other claims are excepted from discharge because of the very nature of the claim and are excepted without regard to any culpability on the part of the debtor. For example, support obligations and many tax claims are nondischargeable. The societal interest in seeing these debts paid outweighs the debtor's need for a fresh economic start.

Congress created the first federally insured student loan program in the late 1950's. These programs were increased dramatically in the mid 1960's to include loans by private lenders and were likewise insured by the federal government. Not surprisingly, some students who owed debts for these loans sought bankruptcy relief. Until 1976, these debts were dischargeable in bankruptcy proceedings in the absence of fraud on the part of the borrower. Given the length of

time that usually passes between the granting of the loan and the commencement of bankruptcy proceedings, fraud claims were unlikely to be successful.

Discharge of these debts in a few cases involving debtors with excellent prospects for significant future income was perceived to be an abuse of the bankruptcy process. In response, Congress enacted a provision in the Education Amendments Act of 1976 to bar the discharge of educational loan obligations for five years, unless paying the debt would constitute an undue hardship on the debtor. This provision was imported into the Bankruptcy Code in 1978 as § 523(a)(8) and, in 1990, the Bankruptcy Code was amended to extend the repayment period from five to seven years before discharge of the debt was possible in the absence of undue hardship.

These loan programs exist to further federal policy supporting vocational and higher education. Consequently, the loans are made with little or no regard for the borrower's current (and even future) earning potential. While the debtor may be able to generate greater income in the future to repay the obligation, debtors are not required to pursue courses of study that will make them more likely to become highly paid persons in the future. Thus, the argument that the lender has made it possible for the debtor to obtain training that the debtor can use for a lifetime thereafter to generate income is unpersuasive.

Moreover, knowledge and information acquired through vocational and higher education is not different in kind than the information and experience a debtor receives by obtaining a loan guaranteed by the Small Business Administration. The debtor with an unpaid SBA loan discharges that debt (in the absence of fraud), and takes with him or her the intellectual benefits of that loan to start a new business venture. Yet, there is no feeling that SBA loans should be excepted from the Chapter 7 discharge.

The number of cases of individuals discharging student loans that created a stir in Congress in 1976 was relatively small. In fact, the General Accounting Office studied these default rates and concluded they were comparable to consumer credit default rates generally. While these default rates have increased in some years, recent reports indicate that these rates are once again within acceptable limits. Furthermore, the default rates were higher under the more strict dischargeability limit (*i.e.* after 1990) than they had been under the more lenient standard. Reduction in default rates has occurred more in response to a tightening of the programs' lending practices and the operation of shorter term proprietary schools than as a result of the nondischargeability of these obligations under the Bankruptcy Code.

In short, these loans are made to further education policy and are not made with expectations on the part of the lender that the debtor will engage in any specific activity to enable the debtor to repay the debt. Additionally, even if these loans were made with the expectation of repayment out of a debtor's future income, they share that characteristic with all unsecured loans. Moreover, there is no evidence that significant numbers of educational loan borrowers have sought to discharge their debts in bankruptcy. To the contrary, many reported decisions chronicle the lives of debtors who have received training of questionable value and who are making their

way through life under difficult if not impossible economic circumstances. *See Robert F. Salvin, Student Loans, Bankruptcy, and the Fresh Start Policy: Must Debtors be Impoverished to Discharge Educational Loans?, 71 Tulane L. Rev. 139 (1996).* Given the nature of these loan guaranty programs, it is unlikely that a change in the dischargeability status of these claims will have a significant impact on these programs. These guaranties are made through education funding bills that are effective for a period of five years. Congress makes a separate determination for each authorization bill as to the proper amount of funds for which guaranties will be provided. This authorization is the key to the availability of funds to support vocational and higher education, and Congress is well positioned to make any needed adjustments of those programs whenever reauthorizing legislation is considered.

The high default rates of educational loans in the early 1990's have receded. Nonetheless, many of those previously defaulted loans are still outstanding. They are all too often the result of a failed effort at improvement through courses offered by a proprietary school more interested in revenue made available through loan programs than in education supposedly beneficial to the student. When (and if) students complete these programs, they frequently are unable to find employment in their field. Furthermore, the practice of guarantors of regularly suspending the repayment period for these loans effectively stretches them out to well beyond even the seven years now set out in § 523(a)(8). Courts have also interpreted the undue hardship exception to nondischargeability narrowly. Additionally, courts have held some educational loan debts partially nondischargeable on the theory that repayment of some portion of the debt would not constitute an undue hardship. In all, the special protection of educational loan obligations is unwarranted. These loans are not inherently different from other unsecured claims. To the extent that Health Education Assistance Loans involve loans to persons whom the lenders expect to have significant earning power in the foreseeable future, an exception to discharge may be appropriate. General restrictions on the dischargeability of educational loan obligations under § 523(a)(8) should be discontinued.

For the reasons set out in ¶ B.21, below, we believe that loans for medical education governed by special federal legislation, such as the HEAL program, remain nondischargeable under the terms provided by that special legislation. We recommend that these provisions be set out in § 523(a)(8) in place of its current provisions.

Limited nondischargeability of educational loans has been a part of the bankruptcy laws either directly or indirectly since shortly before enactment of the Bankruptcy Code. Arguably, because these government loan and guaranty programs have been operating for these last twenty years under a system limiting their discharge in bankruptcy proceedings, it might be appropriate to retain this system to ensure the continued stability of these programs. While it is questionable whether discharge of these debts would have any significant impact on these programs, this possibility could tip the scales against the proposal that educational loans be made fully dischargeable. If that is the conclusion reached, then we suggest that § 523(a)(8) be amended to reduce the nonpayment period prior to the debt becoming fully dischargeable.

Default rates on educational loans have recently fallen. Various reasons have been offered to explain the reduction, including lower unemployment rates and more careful monitoring of institutions with extraordinarily high default rates. These reductions appear to have occurred without reference to the extension of the pre-discharge loan repayment period from five to seven years in 1990. Thus, increase in the repayment period has not furthered the repayment goals of the loan programs.

Default rates for proprietary schools such as beauty schools and the like, historically have been much higher than those for four year colleges. A number of reasons for these higher rates have been offered, including the lower socioeconomic status of these students as compared to students at institutions of higher learning. Those with lower incomes entering these programs also tend to have lower incomes after completing their training (if it is actually completed). Moreover, these debts are nondischargeable even if the school itself closes prior to completion of the student's education. Upon default, the lender is paid by the guarantor (usually a governmental entity) and the borrower's potential defense that the educational institution failed to meet its end of the bargain is unavailable to the student.

Given these factors, extension of the repayment period in 1990 from five to seven years seems excessive. Furthermore, increase in the repayment period does not appear to have reduced defaults under these programs. Recognizing that these loans are different in kind from other loans does not mean that lenders and guarantors should be almost entirely sheltered from monitoring these programs. In fact, the increase in monitoring seems to have reduced default rates by removing troublesome educational institutions from these loan programs. Thus, we propose that the nondischargeability period for these loans be returned to five years from the current seven years.

Returning the nondischargeability period to the five years that Congress initially created in § 523(a)(8) still substantially protects the governments's interests in collecting loans made on the basis of the debtor's future ability to pay. When debtors receive the training and job skills they bargained for, they are more likely to repay out of the income that their training enabled them to generate. On the other hand, debtors who received inadequate or incomplete training should not be burdened so long that they are effectively discouraged from seeking to improve their economic lot. Permitting debtors to raise defenses against the guarantors of these loans arising out of the failure of educational institutions to deliver on their promises is one way to address the situation. But creating a new category of litigation is a very expensive way to resolve this problem. Giving guarantors five years to recover on their claims before facing even the prospect of discharge absent undue hardship should be sufficient to permit the guarantors to administer loan programs effectively and efficiently.

12. § 523(a)(9): expand to include any unlawful operation of machinery while intoxicated.

Section 523(a)(9) bars the discharge of debts for death or personal injury resulting from the operation of a motor vehicle while intoxicated. Needless litigation has resulted from the limitation of this section to ?motor vehicles." The culpable conduct regulated by this section is operating any machinery while impaired, whenever prohibited by applicable nonbankruptcy law; operating boats, airplanes, or even construction equipment while intoxicated is potentially as culpable as operating cars and trucks in such a condition. The subparagraph should be expanded accordingly.

13. § 523(a)(10): no change.

Section 523(a)(10) provides for Chapter 7 nondischargeability of any debt affected by a denial of discharge under § 727. This provision is necessary to enforce denials of discharge and has presented no substantial difficulty in application. We recommend no change.

14. § 523(a)(11)-(12); § 523(e): eliminate special FDIC provisions.

In 1990, Congress added §§ 523(a)(11), (a)(12), and (e) to the Bankruptcy Code. These provisions were added in response to a series of failures of financial institutions for which the United States provided deposit insurance. These exceptions to discharge could be viewed as appropriate to support the goal of maintaining public confidence in the banking system. Notwithstanding this laudable purpose, however, we believe that these provisions should be deleted from § 523.

The actions covered by these exceptions to discharge already are rendered nondischargeable under §§ 523 (a)(2), (4) or (6). Thus, §§ 523 (a)(11), (a)(12), and (e) are unnecessary. Removing these provisions will require that the agency holding these claims bring a nondischargeability action in the bankruptcy court, assuring prompt resolution of any dischargeability disputes. (Bankruptcy court jurisdiction for disputes involving §§ 523(a)(11)-(12) is not exclusive.) Moreover, these provisions are unlikely to have any deterrent effect, beyond that provided by other nondischargeability provisions, on persons who would intentionally violate their duties.

Finally, these provisions protect a single class of creditors-- depository institutions and the agencies that regulate and insure them. While it may be appropriate to protect this class of creditors, such narrowly tailored legislation can lead to negative consequences for overall bankruptcy policy. Including special nondischargeability provisions, particularly when those claims are already nondischargeable, can only serve to encourage other creditors to seek similar special protection. Ultimately, this can lead to overlapping and conflicting provisions regarding nondischargeability, creating uncertainty and an overall diminution in the protection that bankruptcy law rightly affords debtors. The availability of discharge is central to bankruptcy policy and restrictions on discharge should be adopted only to the extent consistent with fundamental bankruptcy policy. Including provisions such as §§ 523(a)(11) and (12) makes it easier for other groups to seek similar specialized protection from improper debtor behavior by seeking legislative endorsement of their particular interests, often to the detriment of other

creditor interests. Further, extending the list of nondischargeable debts could lead some courts to find claims dischargeable because of the absence of a particular provision within § 523(a) covering them. Consequently, we believe that these provisions should be removed from the section.

15. § 523(a)(13): extend to all criminal restitution orders.

Section 523(a)(13) creates a category of Chapter 7 nondischargeability for restitution orders in federal criminal cases. This provision may be unnecessary, since most restitution orders involve conduct that gives rise to nondischargeability under § 523(a)(6). If the order of restitution is not itself nondischargeable, however, the crime victim might have to prove the extent of damages separately in a proceeding under § 523(a)(6). Section 523(a)(13) eliminates that need. Because we believe that criminal restitution orders reflect culpable conduct properly subject to Chapter 7 nondischargeability, we recommend that the paragraph be amended to include all criminal restitution orders.

16. § 523(a)(14): eliminate.

Section 523(a)(14) was added to the Code in 1994. According to the section-by-section analysis of the 1994 Amendments, the provision was intended to ?facilitate individuals' ability to use their credit cards to pay their Federal taxes." The provision is unlikely to accomplish this result and should be deleted.

To date, § 523(a)(14) has seldom been used. A LEXIS search reveals that this provision has been cited a mere four times since its enactment and has provided the grounds for nondischargeability in only one case. Two reasons may explain this neglect: first, the IRS does not currently allow direct payment of taxes with credit cards; and second, § 523(a)(14) presents potentially difficult tracing problems. How is a court to determine that cash advances were in fact used for the payment of federal taxes? Under the current situation, § 523(a)(14) is likely to generate expense far in excess of any benefit it may provide to credit card issuers.

Even if the IRS changes its regulations to allow tax payment by credit card, § 523(a)(14) will in no way ?facilitate" that process. To the contrary, it is most likely to simply provide an overlapping ground for credit card nondischargeability. *See MNBA America v. Parkhurst (In re Parkhurst)*, 202 B.R. 816 (Bankr. N.D.N.Y. 1996), in which § 523(a)(14) provided additional grounds for nondischargeability to a credit card issuer already pursuing a § 523(a)(2) claim against a pro se debtor. Regardless of whether credit card charges are incurred to pay taxes or to pay for goods or services, the use is culpable only if the debtor intends no repayment.

17. § 523(a)(15): eliminate.

The 1994 Bankruptcy Reform Act introduced a new exception to discharge, § 523(a)(15), for debts arising out of divorce decrees or separation agreements that are not in the nature of alimony, maintenance or support. We recommend that this section be eliminated. The rationale

for the new exception was set forth in the section-by-section analysis of the 1994 Act presented on the House floor and reported at 140 Cong. Rec. H 10, 762 (daily ed. Oct. 4, 1994):

> In some instances, divorcing spouses have agreed to make payments of marital debts, holding the other spouse harmless from those debts, in exchange for a reduction in alimony payments. In other cases, spouses have agreed to lower alimony payments based on a larger property settlement. If such "hold harmless" and property settlement obligations are not found to be in the nature of alimony, maintenance, or support, they are dischargeable under current law. The nondebtor spouse may be saddled with substantial debt and little or no alimony or support. This subsection will make such obligations nondischargeable in cases where the debtor has the ability to pay them and the detriment to the nondebtor spouse from their nonpayment outweighs the benefit to the debtor of discharging such debts.

This rationale presents several difficulties.

First, the problem that the new section purports to deal with arises only when § 523(a)(5) is improperly applied. As outlined above, § 523(a)(5) has uniformly been applied to render nondischargeable any debt arising from a purported property division in a divorce decree or settlement that is actually in the nature of support (including the situation that the analysis posits: a nondebtor spouse's agreement to accept lower alimony payments in exchange for the debtor's agreement to pay jointly owed debts). If § 523(a)(5) is applied correctly, no prepetition support awards (however denominated) will be discharged. Similarly, § 523(a)(15) is unnecessary to address needs for support that arise after entry of the original divorce or separation decree, because state courts should be available to consider modification of the divorce or separation decree. (Indeed, state courts are in a much better position than bankruptcy courts to assess and deal with the support needs of families involved in divorce and separation proceedings.) Section 523(a)(15) is not necessary to meet the support needs of nondebtor family members.

Second, when a court fails to apply § 523(a)(5) correctly, mistakenly treating a genuine support obligation as a property division, § 523(a)(15) does not assure payment of the obligation—it merely creates a Chapter 7 nondischargeable debt that may be fully discharged in Chapter 13.

Third, if an obligation under a divorce decree or settlement really is not in the nature of support, it should be dischargeable. When support is not the issue, there is, of course, no societal need for payment that justifies Chapter 13 nondischargeability. But nondischargeability under Chapter 7 is also inappropriate. As discussed above, Chapter 7 nondischargeability is appropriate for debts contracted through culpable conduct, and nonpayment of awards in divorce or separation cases may be due to circumstances beyond the debtor's control. Indeed, financial problems associated with divorce may well make it difficult for even the best-intentioned debtors to meet their nonsupport obligations. A nondebtor spouse, not in need of support, should not be preferred over other creditors.

Fourth, § 523(a)(15) has the potential for greatly increasing the administrative costs of divorce/ bankruptcy by adding another step before the nonsupport obligations of a debtor are finally determined. Moreover, the wide-ranging determination required by § 523(a)(15) —including a complete review of the financial condition of both parties—may be quite expensive for parties whose resources are already strained.

Fifth, § 523(a)(15) may actually make § 523(a)(5) less effective. A judge, facing a close question about whether a particular debt really is in the nature of support, may have a tendency to err in favor of finding nonsupport, since this finding still allows the judge to consider the relative needs of the parties under § 523(a)(15).

Sixth, § 523(a)(15) increases the extent to which bankruptcy courts intrude into family law issues which have historically belonged under the jurisdiction of state courts. Apart from § 523(a)(15), intrusion of bankruptcy courts into family law issues is minimal. In determining the extent of support obligations under § 523(a)(5), a bankruptcy court has simply to decide whether a prior state court order was, in fact, for support. The bankruptcy court does not adjudicate support entitlements; it only identifies the nature of the state court's order. When issues of nondischargeability under § 523(a)(15) are raised, however, the inquiry is quite different. Section 523(a)(15) requires determination of the relative hardships to the parties, apparently as of the time of the bankruptcy court hearing: if benefit to the debtor outweighs detriment to the nondebtor, discharge is allowed; if the debtor has the ability to pay and hardship to the nondebtor outweighs benefit to the debtor, discharge is denied. This balancing test necessitates a determination of the present financial capabilities and needs of the parties, precisely the sort of inquiry that state courts must undertake when a party seeks modification of a support order. The question of support is better left to the greater experience, expertise and flexibility of state courts.

Nothing in the case law suggests that § 523(a)(15) is essential for the protection of ex-spouses in Texas or other community property states. Section 523(a)(15) has been pivotal in only one Texas case since its enactment --*Gamble v. Gamble* (*In re Gamble*), 196 B.R. 54 (Bankr. N.D. Texas 1996), in which the court decided the balancing test against the debtor and held the property obligation nondischargeable. Other Texas cases apply § 523(a)(5) in the usual way and find the debt either a nondischargeable support obligation or a dischargeable property division, as appropriate. *Compare Johnson v. Arcelus* (*In re Johnson*), 162 B.R. 130 (Bankr. S.D. Texas 1993) (finding a nondischargeable support obligation), and *Semrow v. Robinson* (*In re Robinson*), 122 B.R. 502 (Bankr. W.D. Texas (1990) (same), *with Davidson v. Davidson* (*In re Davidson*), 133 B.R. 788 (N.D. Texas 1990), *reversed* 947 F.2d 1294 (5th Cir. 1991) (lower court holding that certain payments were not for support and, thus, were not within 523(a)(5) reversed on grounds that debtor is estopped from claiming payments were a division of property when he treated them as alimony for tax purposes). Elimination of § 523(a)(15), therefore, would not detrimentally affect an ex-spouse owed support by a Texas bankruptcy debtor.

Beyond the difficulty in its rationale, § 523(a)(15) has presented substantial difficulties in its application. Courts have struggled to determine which party should have the burden of proof on the question of the debtor's ability to pay nonsupport obligations, and on the balance of

hardships. Moreover, questions have been raised concerning the time as of which the determination of financial condition should be made (the time of the state court order, the time of the bankruptcy filing, the time of the dischargeability proceeding, or the time of the hearing). If the provision is not eliminated, as we recommend, it should be amended to clarify both of these issues. We believe (1) that the burden should be on the nondebtor spouse to establish both that the debtor has the ability to pay the entire property settlement from disposable income as the obligation is due, and that benefit to the nondebtor spouse of this payment would outweigh detriment to the debtor, and (2) that the time for this determination should be as of the hearing on dischargeability. Finally, if § 523(a)(15) remains within the exclusive jurisdiction of bankruptcy courts pursuant to § 523(c)(1), § 523(a)(3) should be an amended to add § 523(a)(15) to the claims that are nondischargeable if notice was not given in time to allow timely filing of a dischargeability complaint. The best way to eliminate these questions regarding application of § 523(a)(15), however, is simply to remove the section.

18. § 523(a)(16): no change.

Section 523(a)(16) was added to the Code by the 1994 Bankruptcy Reform Act. As reflected in the section-by-section commentary to that Act, the new section was designed "to except from discharge those fees that become due to condominiums, cooperatives, or similar membership associations after the filing of a petition, but only to the extent that the fee is payable for time during which the debtor either lived in or received rent for the condominium or cooperative unit." This provision addresses a conflict that existed among courts regarding whether postpetition condominium fees were **?**claims" arising prepetition and hence subject to discharge. Although this issue is not a question of personal culpability, the new provision resolves the condominium fee question in a fair manner that has caused no substantial difficulty in application. We recommend no change.

19. § 523(a)(17): eliminate.

Congress recently added § 523(a)(17) to the Code. That section provides generally that unpaid filing fees and other costs assessed by a court in connection with filing a case are nondischargeable in a subsequent bankruptcy proceeding, regardless of the debtor's status as an indigent or prisoner. The provision apparently was intended to prevent prisoners who engage in vexatious litigation from discharging debts incurred in the conduct of that litigation. Preventing the discharge of those amounts arguably protects the integrity of the courts conducting that prior litigation. Again, however, like the special protections given to federal depositary insurance agencies, this protection is already available in large measure under § 523(a)(6) of the Bankruptcy Code. Furthermore, this provision has had no significant impact on the issues that it governs. Prisoners who file frivolous litigation are subject to sanctions under Fed.R.Civ.P. 11 and similar provisions that are nondischargeable under § 523(a)(7).

In addition, the reach of § 523(a)(17) greatly exceeds the problem it apparently sought to address. As drafted, the provision arguably renders nondischargeable all debts for filing fees and costs in all civil cases. This includes debts that would be dischargeable under any other

circumstances and debts that involve no culpability. This overreaching demonstrates one of the potential hazards posed by provisions that are enacted in response to a perceived problem but that are not evaluated for their impact on bankruptcy policy. We recommend that the provision be eliminated.

20. § 523(a)(18): transfer to § 523(a)(5).

Section 523(a)(18) was added to the Code by § 374 of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. It was intended "to ensure that a debt owed to the State 'that is in the nature of support and that is enforceable under [part D of title IV of the Social Security Act] cannot be discharged in bankruptcy proceedings." We recommend placing this provision in § 523(a)(5) to make it nondischargeable in Chapter 13 as well as in Chapter 7, for the reasons set forth above in the discussion of § 523(a)(5).

21. § 523(b): no change, protect HEAL loans and include them in § 523(a)(8).

Section 523(b) provides that the dischargeability of a debt excepted from discharge in a prior case is governed anew by § 523(a) in the second proceeding. Generally, this is a sensible result. For example, an educational loan debt that was excepted from discharge in the first case because the repayment period was only one year at the time the first case was filed, could be seven or eight years old at the time of the second case. The debt is dischargeable in the second case because it is now "old" enough to not fit within § 523(a)(8). Simply stated, the dischargeability provisions operate independently in each bankruptcy proceeding. The reference in § 523(b) back to § 523 (a), however, has the effect of overriding the special nondischargeability provisions governing health education loans. Their dischargeability is thus determined solely by reference to the "lower" standards for dischargeability. *See, e.g., In re Tanski*, 195 B.R. 408 (Bankr. E.D. Wis. 1996). The effect of this provision then is to reduce the standard for dischargeability that Congress specifically created for these loans. If separate standards are justified in the first case, we see no reason why they should not also govern dischargeability of the debt in subsequent cases. It is only because these standards are contained outside of § 523 that they are not completely picked up in § 523(b).

Health Education Assistance Loans and related programs arguably are different from other student loan programs. The earning potential of medical professionals is generally much greater than the earning potential of the rest of the population. Some of these programs also are intended to address geographical distribution of health care professionals and the availability of health care services to groups who may be underserved. For these reasons, Congress has chosen to make discharge of these debts more difficult than discharge of other student loan obligations. There is a lengthier repayment period prior to dischargeability, and even if that time has passed, the debt is still nondischargeable unless the court finds that it would be unconscionable not to discharge the debt. Moreover, with regard to HEAL loans, the Secretary retains the ability to set off payments that would otherwise be due to the health care professional in order to satisfy the debt. Finally, when Congress created these loan programs, it included these restrictions on discharge as an integral part of the programs from their inception.

We do not quarrel with the policy decision to treat these debts differently from other educational loans. We propose, however, that these nondischargeability provisions be moved from Title 42 to § 523(a)(8) of the Bankruptcy Code. If current § 523(a)(8) is repealed, the provision governing HEAL loans could replace it. If the section is not repealed, then language covering HEAL loans could be added to the section as an additional paragraph. We suggest the move from Title 42 to the Bankruptcy Code for two reasons. First, these provisions essentially are bankruptcy laws. Second, moving these subcategories of educational loans into § 523(a)(8) would avoid a problem that currently exists when a debtor with a loan of this type seeks a second bankruptcy discharge.

22. § 523(c): change to eliminate collateral estoppel effect of true defaults.

Under § 523(c), bankruptcy courts have exclusive jurisdiction to hear dischargeability actions brought under §§ 523(a)(2), (4), (6) and (15), among the most frequently litigated grounds for exception to discharge. Exclusive jurisdiction over these matters was first given to bankruptcy courts by a 1970 amendment to the 1898 Bankruptcy Act. The legislative history to that amendment indicated that it was intended to avoid situations in which debtors failed to defend themselves in state court actions because of ?an inability to retain an attorney due to lack of funds" or because of a mistaken reliance on a bankruptcy discharge. H.R. Rep. 91-1502, 91st Cong., 2d Sess. at 1 (1970). The 1970 legislation was intended to deal with state court action affecting the debtor's discharge *after* bankruptcy filing. Since enactment of the Bankruptcy Code, however, a similar set of problems has arisen with state court actions commenced *before* bankruptcy filing. The creditor holding a potentially nondischargeable claim often files a state court complaint before the debtor has commenced a bankruptcy proceeding and the debtor fails to respond, either due to a lack of financial resources to hire an attorney or due to a mistaken belief that a later bankruptcy would discharge the debt in any event. (Such a complete failure to respond to a complaint is referred to as a ?true default" to distinguish it from situations in which the debtor does appear for some portion of the proceedings, but does not participate through a trial.) Several recent decisions have held a state court's default judgment, even in situations of true default, binding on the bankruptcy court under principles of collateral estoppel. *See, e.g., Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798 (9th Cir. 1995); *Bay Area Factors v. Calvert (In re Calvert)*, 105 F.3d 315 (6th Cir. 1997).

These decisions rest on 28 U.S.C. § 1738, which provides that federal courts give full faith and credit to state court decisions. Generally, this rules applies to bankruptcy cases in an entirely reasonable manner, avoiding the unnecessary expense of a retrial of matters already fully adjudicated. In situations of true default, however, application of 28 U.S.C. § 1738 to enforce the default judgment is inconsistent with the exclusive jurisdiction of the bankruptcy courts over dischargeability actions provided in § 523(c): individuals in need of bankruptcy relief may well have no ability or incentive to respond to state court lawsuits that might later give rise to claims of nondischargeability. Indeed, potential debtors may quite reasonably believe that any question about the dischargeability of their debts would only be decided in a bankruptcy case.

The United States Supreme Court dealt with a similar situation, from the creditor's perspective, in *Brown v. Felsen*, 442 U.S. 127 (1979). There, a creditor had filed a prebankruptcy state court action, and obtained a stipulated judgment. The creditor failed to allege fraud in the state court action, however. In the later bankruptcy, the creditor asserted a fraud claim as grounds for an exception to discharge, and the debtor responded that the claim should be barred by res judicata, because it was not raised in the earlier state court action. The Supreme Court rejected this argument and held that the bankruptcy court should consider the fraud claim. One reason the Court offered for this conclusion was the inefficiency and inappropriateness of making creditors litigate issues unnecessarily. *Id.* at 135. If a creditor obtains a judgment for the requested amount, there is no reason for the creditor to pursue proof of additional counts against the debtor that will result in no greater recovery. *Brown v. Felsen* prevents the creditor from being penalized for failing to pursue that wasteful effort. The same principles should apply to debtors. They should not be penalized for failing to expend their limited funds in what would appear to be wasteful efforts. Cases such as *Nourbakhsh* and *Calvert* reverse that dynamic, in some states, and require debtors to incur the expense of defending these suits. This defense comes at a time when the debtor expects to file for bankruptcy relief and could not possibly know whether the creditor will even seek to have the debt declared nondischargeable in the future bankruptcy proceeding.

Moreover, enforcing state court default judgments under 28 U.S.C. § 1738 results in a substantial lack of uniformity in discharge litigation. This problem can be seen by comparing *Nourbakhsh*, in which the Ninth Circuit held the debt nondischargeable based on a state court default judgment, with *In re Davis*, 1996 WL 733174 (9th Cir., Dec. 16. 1994), another Ninth Circuit case, reaching the opposite result. The only real difference between the two cases is that one default judgment was rendered in California (*Nourbakhsh*) and the other default judgment was rendered in Arizona (*Davis*). Default judgments have collateral estoppel effect in California, but not in Arizona. Thus, availability of a bankruptcy discharge turned on geographical location rather than on principles of bankruptcy law.

Finally, as *Brown v. Felsen* also emphasized, exclusive jurisdiction over defined dischargeability actions was accorded to the bankruptcy court in part **?**so that it could develop expertise in handling them." 442 U.S. at 135-36. This policy is undercut by enforcing state court default judgments as to issues bearing on dischargeability.

We therefore propose that § 523(c) be amended to include a provision that, as to complaints to establish nondischargeability on grounds set forth in § 523(c) (that is, grounds within the exclusive jurisdiction of the bankruptcy court), full faith and credit not be extended to any judgment arising from a true default, notwithstanding 28 U.S.C. § 1738.

This proposal only deals with true default judgments. If the debtor actually appears in a state court proceeding, so that some actual adjudication takes place, full faith and credit would continue to be extended pursuant to state court rules, under § 1738.

23. § 523: add a new paragraph authorizing the award of money damages in dischargeability actions.

Section 523 of the Bankruptcy Code, in general, authorizes bankruptcy courts to determine whether certain debts are excepted from a debtor's discharge. Paragraph (d) authorizes the court in limited circumstances to ?grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding " The section does not, however, specifically authorize the bankruptcy court to enter a money judgment on the underlying debt when it determines that the debt is not dischargeable.

The absence of authority for entry of such money judgments has created some difficulty for the courts. For example, in *In re Thrall*, 196 B.R. 959 (Bankr. D. Colo. 1996), the court refused to enter a money judgment in favor of a creditor despite holding the debt nondischargeable. The court noted that a determination of nondischargeability is separate from a ruling on the underlying indebtedness. The court expressed concern for protection of the debtor's right to a trial by jury, and also found that the jurisdictional grant given bankruptcy courts did not reach the noncore proceeding on the alleged debt. Instead, the court viewed the matter as analogous to the adjudication of a prepetition claim that the Supreme Court in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co*, 458 U.S. 50 (1982), held could not be adjudicated by a bankruptcy court. *See also In re Hooper*, 112 B.R. 1009 (Bankr. 9th Cir. 1990); *In re Barrows*, 182 B.R. 640 (Bankr. D.N.H. 1994); *In re Marlar*, 142 B.R. 792 (Bankr. E.D. Ark. 1992).

This lack of specific authority to enter money judgments on the underlying debts in nondischargeability actions has not troubled all courts, however. The Ninth Circuit recently held that the bankruptcy court may issue such judgments. *Cowen v. Kennedy (In re Kennedy)*, 1997 WL 127247 (9th Cir., March 21, 1997) (amending 108 F.3d 1015). The court there held that the bankruptcy court ?acted within its jurisdiction in entering a money judgment . . . in conjunction with a finding that the debt was nondischargeable." It noted that this result was consistent with results reached in the Second, Fifth, Sixth and Seventh Circuits. *In re Porges*, 44 F.3d 159 (2d Cir. 1995); *In re Vickers*, 546 F.2d 1149 (5th Cir. 1977)(decided under the Bankruptcy Act); *In re McLaren*, 990 F.2d 850 (6th Cir. 1993); *In re Hallahan*, 936 F.2d 1496 (7th Cir. 1991).

Notwithstanding the rulings in the courts of appeals, the decisions in *Thrall* and similar cases raise serious question as to the authority of bankruptcy courts to enter money judgments in conjunction with dischargeability actions. The Commission's recommendation that bankruptcy judges be appointed under Article III of the Constitution may eliminate much of the controversy, allowing jury trials in dischargeability cases to the extent required by the Constitution. Regardless of the Article III issue, however, we recommend the addition of a new paragraph to § 523, providing specific authority to bankruptcy courts to issue money judgments in connection with dischargeability complaints. As the circuit court decisions noted above have recognized, determination of these complaints—which are central to the scope of the debtor's discharge—necessarily requires determination of the existence of an underlying debt. To require that the extent of the debt be determined in a separate state court proceeding is wasteful duplication.

24. § 523(d): change to make mandatory an award of attorneys' fees and costs to consumer debtors prevailing in dischargeability litigation.

Section 523(d) currently provides that debtors who prevail in dischargeability litigation "shall" be granted a judgment for their costs and reasonable attorneys' fees. The provision is qualified, however. Costs and fees may be awarded only if "the position of the creditor was not substantially justified" and may not be awarded if "special circumstances would make the award unjust." These conditions have resulted in a reluctance by many courts to award fees and costs to prevailing debtors, with the result that debtors cannot be assured of recovering their costs of litigation when they prevail. This, in turn, provides a substantial incentive to debtors to agree to settlements even of nondischargeability claims that are not well founded. To encourage adequate representation of consumer debtors, we strongly recommend that, as to debtors with primarily consumer debts, the award of costs and attorneys' fees be mandatory.

25. § 523(e): eliminate.

See the discussion of this issue in ¶ 14 of this report.

26. § 523: add a new paragraph eliminating vicarious liability.

Section 523(a) of the Bankruptcy Code sets out a variety of claims that are excepted from discharge. Among the more litigated categories of nondischargeable debts are those for false pretenses, a false representation, or actual fraud. If a debtor intentionally makes a false representation upon which a creditor justifiably relies and the creditor suffers damages as a result, then that claim is nondischargeable in the debtor's bankruptcy case. If the debtor is a partner in a general partnership and has made the misrepresentation in the course of the partnership's business, then the other general partners of the partnership are liable to the creditor for damages suffered. Moreover, the debt owed by the other general partners has frequently been held nondischargeable in the event they seek bankruptcy relief. *BancBoston Mortgage Corp. v. Ledford (In re Ledford)*, 970 F.2d 1556 (6th Cir. 1992); *Luce v. First Equipment Leasing Corp. (In re Luce)*, 960 F.2d 1277 (5th Cir. 1992); *Moore v. Gill (In re Gill)*, 181 B.R. 666 (Bankr. N.D. Ga. 1995). The transferability of nondischargeability status to other partners can be traced to the Supreme Court's decision in *Strang v. Bradner*, 114 U.S. 555, 5 S.Ct. 1038, 29 L.Ed. 248 (1885). We question whether the rules should continue to apply today.

Most of the situations in which nondischargeability status is imputed to other partners arise under §§ 523(a)(2), (4) or (6). Generally speaking, these debts involve fraud, defalcations by fiduciaries, and willful and malicious injuries caused by debtors. Common among those categories is intentional action by the wrongdoer. The current rule, as evidenced by the cited decisions, transfers that intention from one partner to another.

Debts are excepted from bankruptcy discharge for two reasons. By prohibiting discharge, the Code operates to deter intentional misconduct as well as to prevent the debtor from retaining benefits from the inappropriate action. In the case of an innocent partner, however, these puposes

for the exception to discharge are not relevant. There is no inappropriate intentional activity to be deterred. And the ?innocent" debtor does not necessarily gain from the wrongdoing partner's inappropriate activity: for example, in the simple situation of a theft by one partner of goods entrusted to the partnership, the other partners retain no benefit. Moreover, any benefit gained by the partnership generally will be among the assets available for distribution to all of the partnership's creditors. No policy of bankruptcy law is furthered by creating a nondischargeable debt in these circumstances.

These arguments apply to any obligation for which a debtor is vicariously, as opposed to directly, liable. Therefore, whether the debtor is the spouse of a wrongdoer, the employer of the wrongdoer or the principal of a wrongdoing agent, nondischargeability of the underlying obligation in the wrongdoer's bankruptcy should not lead to nondischargeability of that debt in the other proceeding. Of course, to the extent that the debtor's own actions are sufficient to meet the applicable standard of nondischargeability, then the debt caused by those actions may be excepted from discharge.

27. § 727(a) objections to discharge: no changes; no provision needed to deal with exemption planning.

We recommend no changes with respect to the substantive grounds for denial of discharge under § 727(a). Because pending recommendations regarding exemptions may reduce the potential for exemption planning, we have not considered that issue.

28. § 727, new paragraph regarding settlement and dismissal.

Bankruptcy Rule 7041 provides that "a complaint objecting to the debtor's discharge shall not be dismissed at the plaintiff's instance without notice to the trustee, the United States trustee, and such other persons as the court may direct, and only on order of the court containing terms and conditions which the court deems proper." The 1983 Advisory Committee Note explains this rule's purpose as follows:

> Dismissal of a complaint objecting to a discharge raises special concerns because the plaintiff may have been induced to dismiss by an advantage given or promised by the debtor or someone acting in his interest. Some courts by local rule or order have required the debtor and his attorney or the plaintiff to file an affidavit that nothing has been promised to the plaintiff in consideration of the withdrawal of the objection. By specifically authorizing the court to impose conditions in the order of dismissal this rule permits the continuation of this salutary practice.

The concern raised by the rule and the note is that an objection to discharge— which, if successful, would benefit all creditors of the estate—might be dismissed on the basis of consideration flowing only to the creditor who filed the action. The same concern applies to settlements of objections to discharge. *See In re Nicolosi*, 86 B.R. 882, 888 (Bankr.W.D.La. 1988) (questioning whether "there can ever be a compromise of an objection to discharge that would involve receipt of compensation or remuneration by a creditor.")

We recommend that these concerns be addressed in the Bankruptcy Code itself, rather than left to the discretion of individual bankruptcy judges operating under the Federal Bankruptcy Rules. A new paragraph should be added to § 727 providing that (a) any complaint objecting to discharge may only be dismissed on motion of the plaintiff after notice given to the United States trustee, the case trustee and all creditors entitled to notice, advising them of an opportunity to substitute as plaintiff in the action; (b) any motion to dismiss a complaint objecting to discharge must be accompanied by an affidavit of the moving party disclosing all consideration given or promised to be given by the debtor in connection with dismissal of the complaint; and (c) if consideration is given or promised to be given by the debtor in connection with dismissal, the complaint may not be dismissed unless the consideration benefits the estate generally. These provisions would create a uniform policy against settlements of objections to discharge that prefer the complaining creditor.

29. § 727, new paragraph regarding fees and expenses in connection with objections to discharge.

Under §§ 330(a)(1) and 503(b)(2) of the Code, trustees pursuing an objection to discharge in a Chapter 7 case are allowed an administrative claim for their reasonable expenses in connection with the proceeding. There is no provision for any payment to trustees or their counsel in no-asset cases, however, and no provision whatever for reimbursement of the attorneys' fees and expenses of creditors who bring objections to discharge. (Section

503(b)(3)(D) allows an administrative claim for creditors who make a "substantial contribution," but only in cases under Chapters 9 and 11.) Similarly, there is no provision for payment of the debtor's expenses involved in defense of an objection to discharge. It is appropriate to encourage meritorious objections to discharge, by providing for payment of expenses incurred by the party bringing the action, since these objections enforce the debtor's obligations of full disclosure and fair dealing with assets. On the other hand, debtors should not have to personally bear the cost of nonmeritorious objections.

Accordingly, we recommend that § 503 be amended (1) to allow an administrative claim for the reasonable expenses, including attorneys' fees, of any party that successfully prosecutes an objection to discharge, (2) to provide that if the assets of the estate are insufficient to pay the reasonable expenses (including attorneys' fees) incurred by any party successfully pursuing an objection to discharge, the unpaid expenses will be a personal obligation of the debtor, nondischargeable in any subsequent bankruptcy, (3) to provide that expenses of the debtor reasonably incurred in successfully defending an objection to discharge pursued by the trustee be an administrative expense; and (4) to provide that expenses of the debtor reasonably incurred in successfully defending an objection to discharge pursued by a creditor be charged to that creditor.

30. § 727, new paragraph regarding effect of lack of notice.

Section 523(a)(3)(B) deals with the rights of creditors to pursue dischargeability complaints in the event that they receive notice of the bankruptcy after an applicable filing deadline. Current law, however, may prevent creditors with knowledge of grounds for an objection to discharge from pursuing the objection whenever they do not receive notice of the bankruptcy in time to file. Lack of notice does not provide an exception, under current law, from the deadline to file an objection to discharge. *See* Fed. R. Bankr. P. 4004(a), (b). Moreover, revocation of discharge is allowed under § 727(d) only on limited grounds that appear not to include negligent failure to list a creditor, and even these grounds are only available for one year after the granting of discharge. We believe that a creditor omitted from the schedules should be allowed a reasonable period of time after notice of bankruptcy to file an objection to discharge or a motion to revoke discharge. That period should be established by rule, like other filing deadlines.

31. § 727(d)(1): change date for knowledge of fraud.

Section 727(d)(1) currently allows revocation of discharge if the debtor obtained the discharge through fraud and the party seeking revocation "did not know of such fraud until after the granting of such discharge." A problem arises with this provision whenever the party seeking revocation of discharge learns of fraud before the granting of discharge but after the deadline for filing an objection. A party in this position can neither file an objection to discharge nor, under the current language of § 727(d)(1), seek to revoke discharge after it is entered. This difficulty, which was noted in *Emery v. Citibank (In re Emery)*, 201 B.R. 37 (E.D.N.Y. 1996), can be eliminated by amending § 727(d)(1) to allow revocation of discharge to be sought by a party who learns of fraud by the debtor too late to file a timely objection to discharge.

32. § 1328(a): eliminate several categories of Chapter 13 nondischargeable debt.

Section 1328(a) sets forth the "superdischarge" available to debtors who complete a Chapter 13 plan. As discussed at the outset of this paper, by allowing discharge in Chapter 13 of most debt that would be nondischargeable in Chapter 7, this provision encourages voluntary Chapter 13 filing, larger distributions to the creditor body as a whole, and economic rehabilitation of the debtor. The Code as originally enacted contained only two express exceptions to the Chapter 13 discharge: (1) long term indebtedness on which the debtor proposed to cure defaults through the plan and otherwise maintain payments—an issue that does not raise concerns regarding dischargeability; and (2) family support obligations under § 523(a)(5). In addition, priority tax claims were effectively nondischargeable since, pursuant to § 1322(a)(2), a Chapter 13 plan must provide for payment in full of all priority claims. (For this reason, now that family support claims under § 523(a)(5) are also priority claims, listing them as nondischargeable in § 1328 is redundant. This redundancy creates no problem and, because it may serve to emphasize the importance of family support, we do not recommend its elimination.) Since enactment of the Code, however, several additional categories of Chapter 13 nondischargeable debt have been created.

We recommend that only those debts reflecting a societal need for repayment—like family support and taxes—be nondischargeable in Chapter 13. Debts that simply reflect personal culpability should remain dischargeable in Chapter 13 so as to effectuate the purposes supporting the superdischarge. On this basis we recommend that the following types of debt be eliminated from the list of Chapter 13 nondischargeable debts set forth in § 1328(a): operation of machinery while intoxicated (§ 523(a)(9)), restitution, criminal fines and educational debts. While many of these debts reflect personal culpability, none of them reflects a societal need for repayment. For example, the victim of an intoxicated driver has no greater need for compensation than the victim of an intentional battery. Similarly, the victim of a crime should not be given different treatment in bankruptcy because an order of restitution is issued as opposed to an award of damages in a subsequent civil tort case. The debtor has acted culpably in all of these situations, but bankruptcy policy should allow economic rehabilitation of the debtor who honestly devotes all disposable income to a plan for three to five years.

In the event that debts other than family support obligations and taxes are made nondischargeable in Chapter 13, however, we propose that Chapter 13 debtors be allowed to classify such nondischargeable debt separately from other unsecured claims and pay these debts more than the percentage payments made to other unsecured creditors. The other unsecured creditors are protected by the best interest of creditors test under § 1325(a)(4). We do not propose to grant priority status to any Chapter 13 nondischargeable debts other than family support and taxes because that might have the effect of making Chapter 13 relief unavailable if these debts could not be paid in full during the life of the plan. Instead, we believe that offering Chapter 13 debtors the opportunity to separately classify and prefer these claims over others furthers the goal of obtaining repayment of these debts to a greater extent, and simultaneously

affords debtors the chance to benefit from the budgetary discipline inherent in Chapter 13 proceedings.