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BANKRUPTCY POLICY: TOWARD A MORAL JUSTIFICATION FOR FINANCIAL REHABILITATION OF THE CONSUMER DEBTOR

RICHARD E. FLINT*

Alas for you, lawyers and Pharisees, hypocrites! . . . [y]ou have overlooked the weightier demands of the Law, justice, mercy, and good faith. It is these you should have practiced, . . . Blind guides!¹

The essence of our consumer bankruptcy law² is the discharge.³ The discharge of a consumer debtor frees the debtor from the shackles of

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1. *Matthew 23:23* (The New English Bible).

2. The phrase "consumer bankruptcy" as used in this article refers to individuals who resort to filing bankruptcy under either Chapter 7 or 13 of the Bankruptcy Code. Under Chapter 7, creditors are paid from the proceeds, if any, of the liquidation of a debtor's non-exempt assets at the time of the filing, while in Chapter 13, creditors receive payment pursuant to a plan generally from the future income of the debtor. The bankruptcy law currently in effect is the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, as amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, and by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (codified at 11 U.S.C. and in scattered sections of other titles). The current statute will be referred to as the "Code" and cited as "Bankruptcy Code § ____." The prior statute will be referred to as the "Act" and cited as "Bankruptcy Act § ____."

3. See Hallinan, *The 'Fresh Start Policy' in Consumer Bankruptcy: A Historical Inventory and an Interpretative Theory*, 21 U. RICH. L. REV. 49, 51 (1986) (stating that "[discharge] is, rather, the principal (if not the sole) point of the exercise."); Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985) [hereinafter Jackson, *Fresh Start Policy*] (stating that principal advantage bankruptcy offers to individual is benefits associated with discharge). Discharge represents the most significant benefit for the individual who seeks the protection of the bankruptcy laws. Except in circumstances where the debtor has violated a norm specified in the Code, an individual can receive a discharge of his existing debts in exchange for giving up claims to certain non-exempt assets or a portion of his future income. Bankruptcy Code §§ 523(a), 727(a), & 1328(a). Discharge is viewed as more generous under Chapter 13 than under Chapter 7 for the reason that fewer debts are non-dischargeable under the provisions of Chapter 13.

Although debt collection/creditor distribution is the other primary function of the bank-

existing debt and places him on the economic treadmill once again—to earn, consume and borrow.⁴ Discharge is a substantive bankruptcy provision that changes nonbankruptcy entitlements.⁵ It changes the legal relationship between a debtor and his former creditor, and gives the debtor the beginnings of a fresh start⁶ by immediately freeing all or a portion of his future earnings potential (“human capital”) from his past financial obligations.⁷ Discharge is granted to all who seek the protection of the Code upon complying with certain conditions⁸ and, unless a particular debt comes within a specified type, all debts are released.⁹ This, of course, is only part of the financial rehabilitative function of our present bankruptcy system. The system not only frees human capital, but also provides future protection

ruptcy process, two factors greatly diminish its realization in consumer bankruptcies. Those factors are that most Chapter 7 cases are “no-asset” and that most Chapter 13 debtors make insignificant payments. See D. STANLEY & M. GIRTH, *BANKRUPTCY: PROBLEMS, PROCESS AND REFORM* 20-21 (1971) (showing historically from 1946-69 over seventy percent of Chapter VII cases were no asset); T. SULLIVAN, E. WARREN & J. WESTBROOK, *AS WE FORGIVE OUR DEBTORS* 216 [fig. 12.1], 339 (1989) [hereinafter T. SULLIVAN, *AS WE FORGIVE*] (stating that Consumer Bankruptcy Project conducted by authors showed that two-thirds of debtors in Chapter 13 could not make their payments).

4. Although the credit industry had long touted the fact that following the filing of bankruptcy proceedings debtors would not be able to obtain credit, this does not appear to be the case. See CREDIT RESEARCH CENTER, KRANNERT SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, *MONOGRAPH 24, CONSUMER BANKRUPTCY STUDY VOL. II, PERSONAL BANKRUPTCY: CAUSES, COSTS AND BENEFITS* 136 (1982) [hereinafter *PURDUE STUDY VOL. II*].

5. See, e.g., *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938) (stating that bankruptcy proceedings constantly modify and affect property rights established by state law); *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 188 (1902) (stating that “[t]he grant to Congress [in the Constitution] involves the power to impair the obligation of contracts, and this the States were forbidden to do.”).

6. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (introducing concept of fresh start for debtor following bankruptcy). The Court in *Local Loan* stated that “[o]ne of the primary purposes of the bankruptcy act is to ‘relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.’” *Id.* (quoting *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915)). In *Local Loan* the Court observed that this “fresh start” was a response to public and private interest by permitting “the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.” 292 U.S. at 244 (citations omitted) (emphasis in original). The Court concluded that the provisions of the Act “are to be construed when reasonably possible in harmony with it [the fresh start] so as to effectuate the general purpose and policy of the act. Local rules subversive of that result cannot be accepted as controlling the action of a federal court.” *Id.* at 245.

7. In the case of Chapter 7 this human capital, i.e., the earnings from postfiling employment, is freed from prefiling obligations immediately. Bankruptcy Code § 541(a)(6). Under Chapter 13 the debtor will dedicate a portion of his human capital to a plan for the repayment of his former obligations. Upon the completion of the plan, the debts are discharged and all of his human capital is freed. Bankruptcy Code § 1328(a).

8. See Bankruptcy Code § 727(a).

9. See Bankruptcy Code §§ 523(a), 1328(a).

from past financial obligations¹⁰ and allows a debtor to retain the basic necessities of life¹¹ to continue on the treadmill.¹²

With the continuing rise in the number of consumer bankruptcies¹³ and the willingness of people to seek its protection¹⁴ comes the frequent demand of some to limit the scope and availability of debtor financial relief.¹⁵ These

10. See Bankruptcy Code §§ 524-525. These sections prevent certain types of discrimination because the protections of the Code effectively eliminate any attempts to collect discharged debts from the debtors.

11. Bankruptcy Code § 522(b). Section 522(b) of the Code provides the debtor with a minimum bundle of assets, commonly referred to as exempt property, upon which certain creditors cannot levy execution.

12. All of these attributes have at different times been referred to individually and collectively as reflecting Congressional implementation of the "fresh start policy" in the bankruptcy law. It is through these attributes that Congress strives to obtain the goal of debtor financial rehabilitation. Through the Code, Congress has also imposed certain limitations on the availability and scope of debtor financial relief. It is through an understanding of the basic values forming the justification for the fresh start policy that one can begin to "make sense" of what appears on the surface to be conflicting and/or inconsistent goals sought to be obtained through the implementation of the policy by Congress. See *infra* notes 68-125 and accompanying text.

13. See ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, 1989 ANNUAL REPORT. This Report shows that during the 12 month period ending June 30, 1988, 594,567 petitions were filed compared to 642,993 for the same period ending June 30, 1989; and, that during the period 1984-89, 2,985,505 individual petitions were filed. *Id.* at 27 (Table 9). It is estimated that in the year 1992, 890,000 individual cases will be filed. Smith, *The Bankruptcy Boom*, U.S. NEWS AND WORLD REPORT, June 4, 1990, at 72.

14. See T. SULLIVAN, AS WE FORGIVE, *supra* note 3, at 341 (noting that many Americans feel there is a "growing acceptance and purported de-stigmatization" of the bankruptcy process). Cf. *Perry v. Commerce Loan Co.*, 383 U.S. 392, 395 (1966) (noting that congressional purpose in enacting Chapter 13 was in part to avoid the stigma of an adjudication of bankruptcy).

15. The last changes to debtor financial relief occurred in 1984. See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.). Subtitle A of Title III of the law was entitled the "Consumer Credit Amendments." These changes were designed to attack certain alleged abuses in the system including extremely low payout plans under Chapter 13. I use the phrase "alleged abuses" because few suggestions, if any, were ever made that people abused the system as that word is generally understood. See, e.g., Ayers, *Reforming the Reform Act: Should the Bankruptcy Reform Act of 1978 Be Amended to Limit the Availability of Discharges to Consumers?*, 17 NEW ENG. L. REV. 719, 729 (1982) (conceding that only in rare instances might evidence show there to be serious abuse). The complaints seem to focus on the fact that people actually used the provision of the new Code for debtor relief to the purported detriment of the credit industry. See, e.g., S. REP. No. 65, 98th Cong., 1st Sess. 1, 16 (1983) (noting that under then-present statute courts were approving Chapter 13 plans where debtors were "occasionally paying nothing").

The credit industry undertook an extensive campaign to "prove" that the new Code was responsible for the increased bankruptcy filings. See Sullivan, Warren, & Westbrook, *Laws, Models, and Real People: Choice of Chapter in Personal Bankruptcy*, 13 LAW & SOC. INQUIRY 661, 668-70 (1988) [hereinafter Sullivan, Warren, & Westbrook, *Real People*]. The industry also financed a major economic study to determine how much of the "losses" resulting from bankruptcy discharge in fact could have been paid out of future earnings. See CREDIT RESEARCH CENTER, KRANNERT SCHOOL OF MANAGEMENT, PURDUE UNIVERSITY, MONOGRAPH 23, CONSUMER

demands are often coupled with assertions that the current debtor relief provisions do not effectuate the desired objectives of bankruptcy policy. Thus, under this type of normative analysis the provisions of the Bankruptcy Code that implement congressional fresh start policy need to be amended to achieve desired objectives. To evaluate analytically this normative assertion, one first needs to address a more fundamental issue: What is the central justification for financial rehabilitation of the consumer debtor? The answer to this question goes to the very heart of our present consumer bankruptcy process.¹⁶ For without a central understanding of why the process exists, it is not logically possible to evaluate whether the goals obtained by the implementation of that policy through legislation are justified. That is, whether the results achieved reflect the underlying values that Congress sought to encourage through its fresh start policy.

The interests of creditors and debtors in the bankruptcy process are different and generally mutually inconsistent. Furthermore, due to the alleged increases in the cost of credit for all consumers due to bankruptcy¹⁷ and the social costs associated with insolvency,¹⁸ society as a whole has a

BANKRUPTCY STUDY VOL. I, CONSUMERS' RIGHT TO BANKRUPTCY: ORIGINS AND EFFECTS (1982) [hereinafter PURDUE STUDY, VOL. I]; PURDUE STUDY, VOL. II, *supra* note 5. One scholar viewed the proposed changes advocated by the consumer credit industry as a "return to the indentured servant device . . . for mass peonage, with the federal bankruptcy courts providing free collection services for the consumer credit industry." Countryman, *Bankruptcy and the Individual Debtor—And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 827 (1983).

16. See D. STANLEY & M. GIRTH, *supra* note 3, at 10 (discussing justification for financial rehabilitation of consumer debtor). Stanley and Girth observed that:

For centuries bankruptcy laws served this object [debt collection and fair distribution functions] above all others. At the end of the nineteenth century, however, another object became equally important in the United States. The bankruptcy process became also a method of granting relief to the honest but unfortunate debtor, who through ill luck or bad judgement was burdened with more debt that he could afford.

From a creditor's perspective, the bankruptcy process is a collective system that effects both procedural and substantive legal rights. See, e.g., Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982) [hereinafter Jackson, *Entitlements*] ("most of the bankruptcy process is in fact concerned with creditor-distribution questions.") (emphasis in original); see also Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987); Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

17. See PURDUE STUDY, VOL. II, *supra* note 4, at 139 (providing that "[b]y providing a legal method to uncouple the legally binding credit contract between the lender and borrower, the current bankruptcy law could be expected to increase the risk and therefore the cost of all unsecured credit.").

18. See, e.g., F. NOEL, A HISTORY OF THE BANKRUPTCY CLAUSE OF THE UNITED STATES OF AMERICA 187 (1919). Noel stated:

[S]ociety must be seriously injured by the presence of unproductive or discontented members, who through idleness or vicious habits may eventually become public charges. . . . But public policy makes it expedient that insolvent debtors, instead of being forever entangled by obligations as enduring as the task of Sisyphus, shall be given a fresh start in life under the benevolent influence of the ordinary incentives

vested interest in the bankruptcy process.¹⁹ The failure to isolate and identify the central justification for consumer financial rehabilitation is a serious deficiency of legal scholarship. Instead of facing the issue head on, numerous ad hoc approaches have been proposed to justify each respective proponent's normative goals.²⁰ Nevertheless, the need to develop a theoretical justification for debtor financial relief has been recognized.²¹ Knowledge and acceptance of a central justification with its underlying values can shed light on the proper scope of the present law and aid policy makers and courts in evaluating future bankruptcy issues.

The purpose of this paper is to suggest that the central justification for the debtor financial relief provisions of the Bankruptcy Code is founded in

to industry and enterprise.

See generally Sullivan, Warren & Westbrook, *Limiting Access To Bankruptcy Discharge: An Analysis Of The Creditors' Data*, 1983 WIS. L. REV. 1091, 1138-1145 [hereinafter Sullivan, Warren & Westbrook, *Limiting Access*].

19. See *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 192 (1902) (stating that status of debtor is matter of public concern). In *Hanover*, which is one of the leading Supreme Court cases discussing the purpose of the Bankruptcy Act, the court noted that "[t]he determination of the status of the honest and unfortunate debtor by his liberation from encumbrances on future exertion is matter of public concern. . . ." *Id.* (emphasis in original). One early commentator noted that the Bankruptcy Act expressed "commercial common sense" in that the "unfortunates, who have been in bondage to debts and judgments . . . might be free again; and the country will quickly feel the effects of the restored energy. . . ." J. BUSH, *THE NATIONAL BANKRUPTCY ACT OF 1898* 19 (1899) (quoting from an article by Mr. Hotchkiss entitled "Bankruptcy Laws, Past and Present").

20. See, e.g., Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59, 72-73 (1986) [hereinafter Gross, *Preserving Fresh Start*] (advocating a narrow construction of the 1984 amendments to the Bankruptcy Code); Hallinan, *supra* note 3, at 53 (suggesting economic risk analysis to justify increasing use of Chapter 13); Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1069 (1987) (proposing new functional economic theory of discharge to counter attempts to limit discharge); Jackson, *Fresh Start Policy*, *supra* note 3, at 1394-95 (stating that use of analytical techniques from psychology to economics to justify nonwaivability of discharge is justified by characteristic of human behavior); Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 776-78 (1983) (suggesting that nonwaivability of discharge is paternalistic response to personality changes). Cf. T. SULLIVAN, *AS WE FORGIVE*, *supra* note 3, at 341 ("[W]e identify the centrality of the moral questions and call for a shift in the focus of bankruptcy debates."); Gross, *The Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions*, 65 NOTRE DAME L. REV. 165, 200 (1990) [hereinafter Gross, *Modern Day Peon*] (asserting that policies relating to discharge must be based on truths whose basis may be in philosophy, religion or social custom).

21. In 1970 the Congress established the Commission on the Bankruptcy Laws of the United States for purposes of analyzing, evaluating, and redrafting the Bankruptcy Act. The commission was to include in its study a report on the philosophy of bankruptcy. S.J. RES. 88, 84 Stat. 468 (1970). The Commission concluded that there was a lack "of either an articulated or widely accepted policy that explains and justifies the bankruptcy process. . . ." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93rd Cong., 1st Sess. pt. I, 62 (1973) [hereinafter COMMISSION REPORT]. This conclusion was especially true in the area of debtor financial relief. Other than statements that the purpose of the consumer bankruptcy system was to give a "fresh start" to the debtor, apparently few individuals had given serious attention to articulating a clear, concise, or cogent justification for the debtor relief aspects of the Code.

a natural law theory of morality.²² A review of the history of bankruptcy legislation substantiates this moral justification²³ for debtor relief encompassing the attributes of social,²⁴ distributive,²⁵ and commutative

22. The term "natural law" as used here refers to that body of jurisprudence that maintains a connection between law and morality free from metaphysical and theological pretensions. See generally R. HITTINGER, *A CRITIQUE OF THE NEW NATURAL LAW THEORY* (1987). This usage conforms with the traditional definition of natural law, which refers loosely to those moral, jurisprudential, and political theories which recognize that there are logical and conceptual relationships between law and morality.

Natural law discourse is not without its critics. See Hittinger, *Varieties of Minimalist Natural Law Theory*, 34 *AM. J. JURIS.* 133 (1989) [hereinafter Hittinger, *Minimalist Theory*] (providing that "[o]ne of the most persistent criticisms of natural law discourse is that it is difficult to sort out whether the term natural law is used only as an emblematic circumlocution for 'beliefs not currently in question,' or whether it expresses something philosophically substantive—that is, something that might constructively guide inquiry about matters of law and morals."). See also L. FULLER, *THE MORALITY OF LAW* 102 (1964) (stating that "the term 'natural law' has been so misused on all sides that it is difficult to recapture a dispassionate attitude toward it.").

23. The term "moral justification" as used in this article means the identification and articulation of principles of "practical reasonableness" or "modes of responsibility" upon which the debtor relief provisions of the Code lie. These principles or modes consist of a set of general moral norms by reference to which various forms of unreasonableness in choosing among human goods or values can be identified. In doing so, this article relies generally upon the theory of natural law originally articulated by Germain Grisez and further elaborated upon by John Finnis. J. FINNIS, *NATURAL LAW AND NATURAL RIGHTS* (1980) [hereinafter J. FINNIS, *NATURAL LAW*]; G. GRISEZ, *THE WAY OF THE LORD JESUS, VOL. I, CHRISTIAN MORAL PRINCIPLES* (1983) [hereinafter G. GRISEZ, *MORAL PRINCIPLES*]. The focus of their theory of natural law is centered on an exploration of the "requirements of practical reasonableness in relation to the good of human beings who, because they live in community with one another, are confronted with problems of justice and rights, of authority, law and obligation." J. FINNIS, *NATURAL LAW*, *supra*, at 351. The derivation of laws and obligations in that community comes from principles founded on reasonableness. *Id.* Although clearly beyond the scope of this article, the author notes that there has been serious academic work on the relationship of Christian ethics and the economy. See generally M. MEEKS, *GOD THE ECONOMIST* (1989).

24. As used in this article social justice means "that persons have an obligation to be active and productive participants in the life of society and that society has a duty to enable them to participate in this way." NATIONAL CONFERENCE OF CATHOLIC BISHOPS, UNITED STATES CATHOLIC CONFERENCE, *BUILDING ECONOMIC JUSTICE: THE BISHOPS' PASTORAL LETTER AND TOOLS FOR ACTION* 22 (1987) (emphasis omitted) [hereinafter BISHOPS' LETTER]. The concept of social justice also includes a duty to organize economic and social institutions so that people can contribute to society in ways that respect their freedom and the dignity of their labor. *Id.* *But cf.* F. HAYEK, *LAW, LEGISLATION AND LIBERTY—THE MIRAQUE OF SOCIAL JUSTICE* (1976). "[T]he phrase 'social justice' is not, as most people probably feel, an innocent expression of good will towards the less fortunate, but that it has become a dishonest insinuation that one ought to agree to a demand of some special interest which can give no real reason for it." *Id.* at 97. Hayek's criticism of the concept of social justice is based upon the programs by which social justice (redistribution of wealth) are achieved and the resultant weakening of the moral principles of a free enterprise system. *Id.* at 99. He does not agree with the interference that the implementation of social justice objectives has on the capitalistic system that he propounds. However, Hayek believes that justice "in the sense of rules of just conduct" steeped in moral principles can define legitimate constraints upon individual freedom. *Id.* at

justice,²⁶ existing in harmony as a humanitarian response to the financially downtrodden. Thus, the focus of fresh start policy should be on the adequacy of debtor protection, and not upon the economic or political ramifications of that protection.²⁷ The moral justification for fresh start places certain commutative justice limitations upon the distributive justice aspects of debtor relief depending upon the actions of the debtor *vis-a-vis* his creditors. These limitations place the focus of the resolution of issues involving discharge and dischargeability on issues of fairness.

Many legal scholars are skeptical of an assertion that law can have a moral justification.²⁸ This skepticism has dominated some of the policy

97, 100. Thus, economic or political programs that redistribute wealth, although morally satisfying, must, under Hayek's approach, be consistent with his conservative economic model.

25. The term "distributive justice" as used in this article requires that the economic benefits of society be evaluated in relation to those individuals whose basic economic needs are not met. BISHOPS' LETTER, *supra* note 24, at 22. See generally Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472 (1980) (defending the view that positive law may legitimately be used to redistribute wealth when private alternative methods of doing so are likely to be more costly or intrusive).

26. As used in this article the term "commutative justice" refers to the correction or rectification of inequalities that arise between individuals or groups and calls for fundamental fairness in these exchanges. BISHOPS' LETTER, *supra* note 24, at 21. See generally ADAM SMITH, *THE THEORY OF MORAL SENTIMENT* 327-42 (D. Raphael & A. MacFie, eds. 1976) (originally published in 1759) (arguing that jurisprudence from moral perspective involves examination of actions of person who owes obligation to determine if those actions comport with "scrupulous regard to the general rules of justice" and avoiding wronging others or violating one's own integrity).

27. The need for adequate debtor protection has been a recurring theme in bankruptcy jurisprudence. In an earlier attempt to formulate a bankruptcy jurisprudence one author noted that the year of the Jewish Jubilee established the "germ of an equitable principle founded on ethics, humanitarianism, and wise statesmanship" from which debtor relief evolved. Hirschberg, *Bankruptcy Jurisprudence*, 64 ALB. L.J. 232, 232 (1902). He continued by noting that the Bankruptcy Act of 1898 was "emblematic of our modern civilized humanitarian development, and of the principle that 'Justice oft must be tempered with mercy.'" *Id.* at 239. Justice Story stated

one of the first duties of legislation, while it provides amply for the sacred obligation of contracts, and the remedies to enforce them, certainly is, *pari passu*, to relieve the unfortunate and meritorious debtor from a slavery of mind and body, which cuts him off from a fair enjoyment of the common benefits of society, and robs his family of the fruits of his labour, and the benefits of his paternal superintendence.

3 J. STORY, *COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES* § 1101, 6 (1833).

28. See R. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 348 (1990) [hereinafter R. POSNER, *JURISPRUDENCE*] (stating that "[a]s should be clear by now, I am skeptical that moral philosophy has much to offer law in the way of answers to specific legal questions or even in the way of general bearings."); Posner, *Law and Economics Is Moral*, 24 VAL. U. L. REV. 163, 173 (1990) (suggesting that "moral discourse turns out not to provide any sort of solution [to moral issues]. It merely provides a vocabulary in which people can express views that have deep emotional roots. While I do not deny the force of those views and I do not deny that government policy makers should take them into account, I do not think they are analytically fruitful."); Posner, *Wealth Maximization Revisited*, 2 NOTRE DAME J. LAW, ETHICS & PUB. POL'Y. 85, 103 (1985) (stating that "[i]t must also be emphasized that it is a *political* philosophy

justification debates in the area of debtor relief.²⁹ Other scholars avoid addressing this issue altogether and focus solely on whether the policy achieves "desired goals."³⁰ Thus, in the literature of bankruptcy policy as it relates to debtor relief³¹ consideration and discussion of allocation of

that I am expounding.") (emphasis in original).

H.L.A. Hart, one of the most distinguished modern legal positivists, in discussing the methodology of focusing on the legal order as it is and not on how it ought to be stated: "[Legal positivism] . . . is not concerned with any ideal law or legal system . . . its concern with law is morally, politically and evaluatively neutral." Hart, *Legal Positiveness*, 4 *Ency. of Phil.* 418, 419 (1967). Skeptics assert that because there is no scientific way to reduce these moral values to a quantifiable form, their use in evaluating law is not analytically feasible. *But cf.* Cohen, *The Myth of Neutrality in Positive Legal Theory: Hart Revisited*, 31 *AM. J. JURIS.* 97 (1986) (suggesting that there can be no value-neutral matrix for positive legal theory).

In any event, the same general negative attitude toward morality as a basis for legal decision-making appears in the courts. *See, e.g.,* Tennessee Valley Authority v. Hill, 437 U.S. 153 (1978). In *Hill* Chief Justice Burger (quoting R. BOLT, A MAN FOR ALL SEASONS, Act I, 147 (Three Plays, Heinemann ed. 1967)) stated: "The law, Roper, the law. I know what's legal, not what's right. And I'll stick to what's legal. . . . I'm *not* God. The currents and eddies of right and wrong, which you find such plain sailing, I can't navigate, I'm no voyager. But in the thickets of the law, oh there I'm a forester." *Id.* at 195 (emphasis in original). Chief Justice Burger observed that he was not capable of making "fine utilitarian calculations" or weighing any values. *Id.* at 187-88.

However, the lack of scientific certainty does not make a morally based approach to resolving legal disputes any more subjective or political than any other value-laced approach. *See* Malloy, *Is Law and Economics Moral?—Humanistic Economics and a Classical Liberal Critique of Posner's Economic Analysis*, 24 *VAL. U.L. REV.* 147, 154 (1990) [hereinafter Malloy, *Is Law and Economics Moral?*]. *Cf.* R. POSNER, *JURISPRUDENCE*, *supra*, at 352 (1990) ("Indeed, weak as the methods of legal reasoning are, they are no weaker than the methods of moral reasoning.").

^{29.} *See* Hallinan, *supra* note 3, at 138-43 (suggesting Bankruptcy Code has ambivalent response to role of moral norms in formulating policy). *But see* Shuchman, *An Attempt At "Philosophy of Bankruptcy"*, 21 *UCLA L. REV.* 403, 444-49 (1973) (suggesting ethical basis for bankruptcy legislation). However, Shuchman's focus is only from the debtor-creditor perspective. His discussion, although enlightening, focuses only on the "duty" or obligation to repay debts and upon how to develop an ethical approach to determine which debts should or should not be repaid. *Id.* at 449-58. It is a sad tribute to his intriguing article that other scholars did not pick up his mantle and expand his ethical viewpoint to include the humanitarian response of society to the debtor.

^{30.} *See, e.g.,* Sullivan, *Reply: Limiting Access to Bankruptcy Discharge*, 1984 *Wis. L. REV.* 1069, 1070 (asserting that to achieve desired goal of making "debtors who are able to repay their debts should be required to do so," Code should be amended to limit access to Chapter 7 while encouraging access to Chapter 13). This approach is, of course, the essence of most normative analysis. However, the uncritical use of normative analysis can, and often does, result in an inversion of legal reasoning. In such a case the decision-maker first decides which decision in a case establishes the desired goal, devises a rule that achieves that result, and works backward. *See generally* Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 *HARV. L. REV.* 1089, 1090 (1972) (noting that first issue faced by legal system is to decide who is entitled to prevail). This type of approach is contrary to critical legal analysis which involves listening to the controversy, ascertaining the facts, and then determining which side to a controversy was supported by the relevant body of law, whether statute or case law. *See, e.g.,* R. BORK, *THE TEMPTING OF AMERICA* 262 (1990).

^{31.} *See* Note, *Criminal Restitution and Bankruptcy Code Discharge—Another case for*

risk,³² contractual impossibility,³³ insurance,³⁴ limited liability,³⁵ and debtor rehabilitation,³⁶ among others,³⁷ dominate the writings.³⁸ The failure to acknowledge or address the moral dimension of debtor financial relief makes

Defining the Scope of Federal Bankruptcy Law, 65 NOTRE DAME L. REV. 107, 128-29 (1989) (listing some of the same considerations that follow).

32. See Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953, 981-82 (1981) (suggesting that risk allocation is one of main factors underlying right of discharge). *But see* Jackson, *Fresh Start Policy*, *supra* note 3, at 1398-1401 (arguing that risk allocation justification for discharge is inadequate).

33. See, e.g., Weistart, *The Costs of Bankruptcy*, 41 LAW & CONTEMP. PROBS. (No. 4) 107, 111-12 (1977) (suggesting relationship between contract doctrine of impossibility and right of discharge).

34. See Hallinan, *supra* note 3, at 100-125 (suggesting that insurance characterization is helpful to explain nonwaivability of discharge and as response to moral hazard problem). See also Sullivan, Warren and Westbrook, *Limiting Access*, *supra* note 18, at 1142. These authors note:

Borrowers can undertake credit commitments with the assurance that even if their financial expectations go badly awry, there is a limit to how much they can lose. Under current law, they cannot be sent to jail and, if they declare bankruptcy, they cannot lose both current assets and future income. If debtors, especially marginal debtors, pay a slightly higher interest rate because of creditors' bankruptcy risk, that charge is their premium for the protection of bankruptcy.

(footnotes omitted).

35. See Jackson, *Fresh Start Policy*, *supra* note 3, at 1399-1401 (discussing similarity between corporate limited liability and discharge).

36. See Howard, *supra* note 20, at 1069 (stating that "only the rehabilitative purpose of restored participation in the open credit economy remains as a meaningful goal of discharge").

37. See T. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY* 225-52 (1986) [hereinafter T. JACKSON, *LOGIC AND LIMITS*] (suggesting certain volitional and cognitive justifications for society's concern to provide safety nets through use of fresh start policy).

38. Such approaches smack of legal positivism which could be favorably compared with Milton Friedman's positive economics. See J. HALL, *STUDIES IN JURISPRUDENCE AND CRIMINAL THEORY* 14 (1958). Such approaches should be and have been rejected not only under this author's moralistic analysis but by pragmatists and advocates of sociological jurisprudence. See, e.g., O. HOLMES, *THE COMMON LAW* 1 (1881) (stating that "[t]he life of the law has not been logic: it has been experience. . . . The law embodies the story of a nation's development through many centuries, and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics."). These approaches would also be rejected by those who see law as an instrument of social order. See, e.g., W. FRIEDMANN, *LAW IN A CHANGING SOCIETY* 384 (Penguin ed. 1959) (stating, "That the content of the rule of law cannot be determined for all time and all circumstances is a matter not for lament but for rejoicing. It would be tragic if the law were so petrified as to be unable to respond to the unending challenge of evolutionary or revolutionary changes in society."). The rejection of legal positivism has found support in the area of bankruptcy policy. See, e.g., Warren, *Bankruptcy Policy*, *supra* note 16, at 811-12 (stating, "I have offered a dirty, complex, elastic, interconnected view of bankruptcy from which I can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision."). *But see* Baird, *supra* note 16, at 834 (proposing that "[t]he world is a messy and complicated place, where justice is often hard to find. But it does not follow that bankruptcy policy should be vague and mysterious and that nothing more can be said other than that bankruptcy judges have a general mandate to do equity, but not too much equity."); Jackson, *Entitlements*, *supra* note 16, at 907 (proposing that there is "a coherent normative theory justifying a bankruptcy system that deals with inter-creditor questions . . .").

these approaches sterile and unrealistic. There is no doubt that the acknowledgment of a moral dimension to debtor financial relief introduces a potentially subjective value-making element into the bankruptcy decision making process. However, that same subjectivity is alive and well under any normative approach. Many scholars are unwilling to admit that their own value judgments permeate not only the focus, but the results of their research.³⁹ The main purpose of this article is to assist lawyers and judges in developing an awareness of the underlying moral justification of the debtor financial relief provisions of the Bankruptcy Code, and to provide them with the freedom to acknowledge and articulate the values underlying that justification.⁴⁰

39. Until the era of the modern law and economic scholars, economists historically have based their models and underlying theories on acknowledged value judgments and assumptions. Value judgments are implicit in the entire area of welfare economics because the basis of that approach of what is a good, bad, or better result or policy is based on beliefs, views, ideas, and opinions of the theoreticians. Furthermore, assumptions laced with values of some kind inevitably are necessary to begin any analysis of economic behavior. John Maynard Keynes himself identified the basic assumptions of classical economic theory and rejected them as not being realistic. J. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 21-22 (1936). Keynes then proceeded to develop his own theory based on his own assumptions concerning the behavior of people. *Id.* at 245-47.

Jackson's vision of the rationality of the bankruptcy laws is based upon his own concept of conservative law and economics. Jackson, *Entitlements*, *supra* note 16, at 859-71 (explaining that author developed "creditor's bargain" model under which most if not all creditors would get equal priority in bankruptcy). He, like the economist from the Chicago School, believes that the predictability of the model is more important than the validity of the assumptions. See FRIEDMAN, *ESSAYS ON POSITIVE ECONOMICS* 3, 7-43 (1953). This approach has been flatly rejected by other economists.

[T]he doughnut of empirical correctness in a theory constitutes its worth, while its hole of untruth constitutes its weakness. I regard it as a monstrous perversion of science to claim that a theory is all the better for its shortcomings; and I notice that in the luckier exact sciences, no one dreams of making such a claim.

Samuelson, *Theory and Realism: A Reply*, 54 AM. ECON. REV. 736 (1964) (emphasis deleted).

40. Another scholar has recognized the need to develop this awareness in the area of bankruptcy law. Gross, *Modern Day Peon*, *supra* note 20, at 200. Gross observes that "the policies relating to bankruptcy discharge cannot simply be a matter of instrumental reasoning. Instead, the discharge policy must be based upon non-instrumental (deontological) truths." *Id.* Gross continues by suggesting that a model for the study of bankruptcy should identify the underlying social, religious, or philosophical values, which she unfortunately fails to identify or discuss. *Id.* Cf. R. DWORIN, *TAKING RIGHTS SERIOUSLY* 67 (1977) ("If a theory of law is to provide a basis for judicial duty, then the principles it sets out must try to justify the settled rules by identifying the political or moral concerns and traditions of the community which, in the opinion of the lawyer whose theory it is, do in fact support the rules. This process of justification must carry the lawyer very deep into political and moral theory . . .") (emphasis in original); Dworkin, "Natural" Law Revisited, 34 U. FLA. L. REV. 165 (1982) (stating that "[a]ccording to naturalism, judges should decide hard cases by interpreting the political structure of their community in the following, perhaps special way: by trying to find the best justification they can find, in principles of political morality, for the structure as a whole, from the most profound constitutional rules and arrangements to the details of, for example, the private law of tort or contract.") (emphasis in original); Gross, *Preserving Fresh Start*, *supra* note 20, at 72 (stating that article was attempt to "provide practical interpretive guidance to aid courts and lawyers" in a narrow construction of the Consumer Credit Amendments).

The moralistic view of debtor financial relief is drastically different and inconsistent with the conservative law and economic approach to the subject, as the emphasis or focus is on the moral dimension of the interaction between debtors and creditors in the community, and not on the efficient allocation of resources by self-serving people in a competitive marketplace.⁴¹ The moral approach stresses that human dignity is of a higher value than the economic benefits or costs associated with achieving a desired economic result.⁴² The moralistic view of debtor relief also differs from the view of modern positivist and critical legal studies proponents who consider any normative approach to the law as indeterminate, and prefer instead to assert

41. Under the conservative law and economics approach, "the idea of a public morality once again becomes untenable because values are transformed into preferences and each preference is assumed to have an equal claim to satisfaction." Fiss, *The Death of Law?*, 72 CORNELL L. REV. 1, 14 (1986). Judge Posner notes that efficiency is not the only social value that governments should consider, but is the only value that courts can promote. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 23 (3d ed. 1986) [hereinafter R. POSNER, *ECONOMIC ANALYSIS*]. But see A. ETZIONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMIC* 22 (1988) (stressing need for law and economics scholarship to expand their classical paradigm to include moral considerations.); Malloy, *Is Law and Economics Moral?*, *supra* note 28, at 160 (stating that "[w]hile economics, capitalism, and democracy are all important factors in helping us understand and promote human dignity, we cannot escape our own personal moral obligation to make each of these factors subservient to the higher values they can promote—freedom, liberty, and human dignity."). This author does not mean to imply that economics is not helpful in answering normative questions. However, its use should be limited to what economics does best. Economists can help organize facts and use statistical analysis to assist in determining if a policy implemented by Congress in fact is obtaining its desired goals. Economic theories can be used to illustrate and illuminate policy issues, but should not be used as the sole source to resolve those issues. "People are too complex, and competing considerations too important, to rest everything on theory, no matter how fervently supported." Millstein, *Economics: Use and Misuse—A Response to Professor Areeda*, 52 ANTITRUST L.J. 539, 550 (1983). See also Seita, *Common Myths in the Economic Analysis of Law*, 1989 B.Y.U. L. REV. 993, 1032-33 (discussing "proper" role of economics in law). See generally R. MALLOY, *LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE* 1-4 (1990) [hereinafter R. MALLOY, *LAW AND ECONOMICS*] (differentiating between economic analysis of law and the study of law and economics).

42. The issue of whether economic analysis can effectively evaluate the costs and benefits of our present bankruptcy system, or for that matter any proposed changes to that system, has been the subject of constant debate. See, e.g., Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROBS. (No. 4) 13 (1977) (suggesting that economic principles can provide "an analytical framework within which to clarify issues, identify more precisely the role which bankruptcy plays, and assess the social consequences of alternative structures for bankruptcy"). But see Shuchman, *Theory and Reality in Bankruptcy: The Spherical Chicken*, 41 LAW & CONTEMP. PROBS. (No. 4) 66, 68 (1977) (noting the lack of empirical information to effectively evaluate the issue). More recently the use of empirical verification of the simplistic economic model of the Purdue Study has come under attack. See Sullivan, Warren & Westbrook, *Real People*, *supra* note 15, at 673 (stating that "[t]hese data [compiled by the authors in their Consumer Bankruptcy Project] suggest to us that the relatively simplistic economic models used in bankruptcy policymaking do not work, a conclusion we believe has relevance in other areas where a simple new model promises to revolutionize policymaking.").

that law is political.⁴³ However, the moral approach suggested in this article is closely associated with the actual historical development of debtors' protection in this country⁴⁴ and with the fundamental precepts underlying the formation of our nation.⁴⁵

This article first will examine the moral justification for the debtor financial relief provisions of the Code. This portion of the article will discuss the various attributes of debtor financial relief and develop a meaningful moral justification for those attributes. In doing so, this article will attempt to defuse the arguments of those critics of natural law who assert that the natural law method is not a useful process for lawyers or judges because the result of such a method depends merely on one's perspective or individual moral values. By stressing that the law reflects reason and conscience, this article should convince even the skeptic that fundamental principles of fairness and humanitarianism form the moral dimension of the debtor relief provisions of the Bankruptcy Code. The end of the first part of this article will review the history of bankruptcy legislation and review judicial decisions to establish that historically the bankruptcy process is and has been a reflection and recognition of the moral fiber of the nation. The second and third parts of this article will apply this developed moral justification to a proposed resolution of two currently unanswered issues involving consumer debtors. These issues involve the lien avoidance power of the debtor and the standard of proof in dischargeability cases.⁴⁶

43. See Kennedy, *The Structure of Blackstone's Commentaries*, 28 BUFFALO L. REV. 209, 211 (1979). See also Fiss, *supra* note 41, at 14 (stating that both critical legal studies approach and law and economics approach "start from a rejection of law as an embodiment of public morality and thus have a common base line").

44. See *infra* notes 125-81 and accompanying text; *Walz v. Tax Comm'n*, 397 U.S. 664, 667-80 (1970) (recognizing that courts frequently have used history in constitutional interpretation of laws). See also Address by Justice J.P. Stevens, Thomas E. Fairchild Inaugural Lecture at the University of Wisconsin (Sept. 9, 1988) (available from the Public Information Office of the Supreme Court of the United States). There Justice Stevens noted:

A judge's use of history must involve more than a search for isolated items of information. A historical inquiry has both a horizontal and a vertical dimension. The isolated fact must be studied in its contemporary setting, as well as in relation to what may have preceded or followed. For history, like law and life itself, involves a process of change, of growth, and of improvement.

Id. at 20 (footnotes omitted).

45. See The Declaration of Independence para. 2 (U.S. 1776).

46. At the time of this writing the Supreme Court has recently decided the questions of the proper standard of proof in dischargeability cases, *Grogan v. Garner*, 111 S. Ct. 654 (1991) (holding after fair balance of conflicting interests of complete fresh start and creditors' interest in recovering full payment of certain nondischargeable debts that preponderance of evidence standard applies under 11 U.S.C. § 523(a)), and is considering the validity of state lien conservation statutes in light of the Code's provision for lien avoidance on exempt property, *In re Owen*, 877 F.2d 44 (11th Cir. 1989), *cert. granted sub nom.* *Owen v. Owen*, 110 S. Ct. 2166 (1990).

On May 29, 1990 the Supreme Court held that restitution orders are dischargeable debts in proceedings under Chapter 13. *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 110 S. Ct. 2126, 2134 (1990). In doing so the court distinguished an earlier decision, *Kelly v. Robinson*,

TOWARD A MORAL JUSTIFICATION FOR DEBTOR FINANCIAL RELIEF

Prior to 1787 the relationship of an insolvent debtor and his creditors rested in the hands of the individual states.⁴⁷ However, the Constitution changed this by expressly granting to Congress the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States."⁴⁸ In response to such authority, Congress has generated five separate statutes on the subject.⁴⁹ True to the Madisonian ideal,⁵⁰ each of these legislative enactments has provided some form of debtor financial relief⁵¹ to deal with a fundamental problem inherent in any credit economy where individuals are free to make and often do make poor economic decisions.⁵²

479 U.S. 36, 50 (1986), which held that restitution obligations imposed as conditions of probation in state criminal actions are nondischargeable in proceedings under Chapter 7. *Id.* at 2129. Although the "result" in Davenport is consistent with the moralistic justification for debtor relief provisions developed in this article, it is extremely disappointing that the Court did not mention any policy justifications for its decision. See, e.g., Note, *supra* note 31, at 139 (stating that "[c]ourts should use [clear and coherent] analysis of fundamental goals and policies to resolve all issues requiring definition of the scope of the Bankruptcy Code.").

47. See 3 J. STORY, *supra* note 27, § 1098, at 1 (noting that under Articles of Confederation individual states possessed exclusive right to pass laws upon subject of bankruptcy and insolvency); F. NOEL, *supra* note 18, at 33-66 (discussing types of insolvency and bankruptcy laws of colonies and states prior to Constitution).

48. U.S. CONST. art I, § 8, cl. 4.

49. The first statute was the Act of April 4, 1800, ch. 19, 2 Stat. 19 [hereinafter 1800 Act], repealed by the Act of December 19, 1803, ch. 6, 2 Stat. 248. The second was the Act of August 19, 1841, ch. 9, 5 Stat. 440 [hereinafter 1841 Act], repealed less than two years later by the Act of March 3, 1843, ch. 82, 5 Stat. 614. The third was the Act of March 2, 1867, ch. 176, 14 Stat. 517 [hereinafter 1867 Act], repealed by the Act of June 7, 1878, ch. 169, 20 Stat. 99. The next act was the Act of July 1, 1898, ch. 541, 30 Stat. 544 [hereinafter Bankruptcy Act], repealed and replaced by the same act of Nov. 6, 1978, 92 Stat. 2549 which took effect on October 1, 1979 [hereinafter Bankruptcy Code].

50. See THE FEDERALIST No. 42, at 277-78 (J. Madison) (Mod. Lib. ed. 1937). In discussing the proposed constitutional provision, James Madison emphasized its breadth by recognizing that it provided relief from debt, prevention of fraud, and uniformity in application. The issue of uniformity in light of conflicting state laws or the absence of federal legislation and the imperfect distinction between insolvency laws and bankruptcy laws dominated the early discussions and judicial decisions. See F. NOEL, *supra* note 18, at 100; *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 194-95 (1819) (discussing difficulties in discriminating between insolvency and bankruptcy laws).

51. See *infra* notes 125-81 and accompanying text (discussing in detail early bankruptcy acts as well as Bankruptcy Act and Bankruptcy Code). The 1800 Act provided only for involuntary proceedings [Section 2, 2 Stat. 21] and permitted discharge only upon the written consent of two-thirds, in number and value, of creditors. Section 36, 2 Stat. 31. Section 4 of the 1841 Act provided for discharge of the voluntary and involuntary debtor unless a "majority in number and value of his creditors" filed written objections. 5 Stat. 443. Section 29 of the 1867 Act (as originally enacted and before amendment) permitted discharge in voluntary and involuntary cases without creditor consent. 14 Stat. 531-32.

52. The problems generated by debt in a contract-based credit economy was well documented by the House Report that accompanied H.R. 8200 (95th Cong. 1st Sess. (1977)), which after Senate amendments, became the Bankruptcy Code. H.R. REP. No. 595, 95th Cong., 2d Sess. 3-4 (1977) [hereinafter HOUSE REPORT], reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 5965. This same fact was also acknowledged by an earlier Congress: "The

Each debtor relief statute has had economic and political ramifications, but each also has had a moral dimension that frequently has been overlooked by modern commentators.⁵³

foundation of loan is trust, wherever securities are not taken; it is confidence; it is credit—all terms which imply risk, and the possibility of failure. The risk relates to the question of solvency or insolvency when the period comes for demanding payment." H.R. REP. No. 5, 27th Cong., 1st Sess. 3 (1841).

53. Early commentators steeped in natural law tradition were no stranger to the moral dimension of bankruptcy legislation. See 3 J. STORY, *supra* note 27, § 1101, at 3. According to Story,

[W]hen the debtors have no property, or have yielded up the whole to their creditors, to allow the latter at their mere pleasure to imprison them, is a refinement in cruelty, and an indulgence of private passions, which could hardly find apology in an enlightened despotism; . . . It is incompatible with the first precepts of Christianity; and is a living reproach to the nations of christendom.

However, more recently, little academic scholarship has been devoted to an ontological or deontological analysis of these issues. This lack of scholarship could at one time been the result of the rejection of the natural law hypothesis and the development of legal positivism. However, with the resurgence of new secular natural law it is surprising that this issue has not been a focal point of discussion. In spite of this resurgence, the answer may be that secular moral philosophy has no objective foundation. See J. MACKIE, *ETHICS—INVENTING RIGHT AND WRONG* 19 (1977) (noting that moral philosophy has been relegated to addressing linguistic or conceptual questions, and that its failure to address questions in ontological terms has led to skepticism); A. MACINTYRE, *AFTER VIRTUE* 235 (1981) (noting that "[m]oral philosophy, as it is dominantly understood, reflects the debates and disagreements of the culture so faithfully that its controversies turn out to be unresolvable in just the way that the political and moral debates themselves are."); G. WARNOCK, *CONTEMPORARY MORAL PHILOSOPHY* 1 (1967) (stating that moral philosophy of twentieth century England is barren).

Some philosophers have argued that secular moral philosophy is doomed because it contains no real authority. See Leff, *Unspeakable Ethics, Unnatural Law*, 1979 DUKE L.J. 1229, 1249 ("To put it concisely, if the applicable God is going to insist upon being incoherent, we really have no choice but to be arbitrary."). J.L. Mackie, a modern moral skeptic, argues that morality still is essential for the maintenance of community life and that the fiction of its objectively authoritative hold over us therefore should be perpetuated for prudential reasons. J. MACKIE, *supra*, at 239. Mackie describes his theory as "what we can make of morality without recourse to God, and hence of what we can say about morality if, in the end, we dispense with religious belief." *Id.* at 48. If no secular moral theory has authority to control human action, one could turn to religious beliefs to provide that authority. See Constable, *A Criticism of "Practical Principles, Moral Truth, and Ultimate Ends" By Grisez, Boyle, and Finnis*, 34 AM. J. JURIS. 19, 22 (1989); Goldsworthy, *God or MacKie? The Dilemma of Secular Moral Philosophy*, 30 AM. J. JURIS. 43 (1985). The problems of secular moral philosophy alluded to above are not any different from those facing other social sciences where value judgments must be made. See Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387, 422-44 (1981) (listing some of value choices implicit in economic analysis of law as practiced); R. MALLOY, *LAW AND ECONOMICS*, *supra* note 41, at 60-101 (comparing values and assumptions of various ideological approaches to law and economics). The fact that values judgments are implicit in moral philosophy should not deter one from asserting that moral philosophy can be useful in resolving issues in the legal realm. See Moore, *Moral Reality*, 1982 WIS. L. REV. 1061, 1152 (positing that moral judgments may in fact be objective). Thus, the response to the moral skeptic should be like that of Cassius to Brutus: "[t]he fault, dear Brutus is not in our stars, But in ourselves, that we are underlings." W. SHAKESPEARE, *JULIUS CAESAR*, Act I, Scene II (Mabie ed. 1905).

The soul of debtor financial relief, the fresh start, is found in the availability of a discharge and in the protection of exempt property.⁵⁴ Together these attributes can be viewed as a unified system whose focus is on the debtor and his future as a living, breathing person. Debtor financial relief should be considered a separate and distinct policy objective of Congress which should not be intertwined with the policies relating to the creditor-oriented debt collection and distribution function of the law.⁵⁵ Debtor financial relief is an ethical and moral response to the inevitable inability to pay debt.⁵⁶ Such a response stands as a beacon in a long history of Anglo-American responses to debtor financial default, which has ranged from death to imprisonment.⁵⁷

There is no doubt that the concept of a fresh start policy can be viewed as ambiguous. Fresh start in comparison to what? Fresh start comprised of what? The concept of fresh start is centered on debt forgiveness.⁵⁸ Any

54. Although the Code generally leaves this protection to nonbankruptcy law, the goal of fresh start found in the Code would be incomplete without understanding the role of exemptions in the overall justification for the fresh start. This approach to bankruptcy fresh start policy differs from that of Professor Jackson who states that "bankruptcy's fresh start policy is largely limited to the protection of human capital." T. JACKSON, *LOGIC AND LIMITS*, *supra* note 37, at 228 (emphasis omitted). However, by developing a moral justification for debtor financial relief, it will become clear that the underlying values for permitting a debtor to retain exempt property are interrelated to the values that are inherent in discharge. A separation of the basic purposes for exemptions and discharge in developing a justification for debtor financial relief distorts the ability to develop a coherent and logical approach.

55. See, e.g., *United States v. Kras*, 409 U.S. 434, 447 (1973) (noting that "Professor MacLachlan has said that the development of the discharge 'represents an independent . . . public policy in favor of extricating an insolvent debtor from what would otherwise be a financial impasse.'" (citation and footnote omitted). Cf. Jackson, *Fresh Start Policy*, *supra* note 3, at 1395-96 (stating that "[d]ischarge, which is available only to individuals, could be granted without a collective proceeding, just as a collective proceeding for parceling out existing assets could be provided without discharge.") (footnotes omitted).

Even though the moral justification for debtor financial relief does not focus on the concerns of creditors, *per se*, debtor financial relief clearly has an impact upon creditor debt collecting ability. But decisions concerning the scope and availability of debtor relief should be totally independent of their economic impact on debt collection.

56. See *infra* notes 81-124 and accompanying text.

57. See generally Cohen, *The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEG. HIST. 153, 157-59 (1982); Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1, 5 (1919); Levinthal, *The Early History of Bankruptcy*, 66 U. PA. L. REV. 223, 229 (1918) [hereinafter Levinthal, *Early History*]. But cf. *Deuteronomy* 15:1-3 (discussing existence of periodic release for debt under Mosaic law). Discharge is not generally available in other legal systems. See J. DALHUISEN, *DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY* § 1.07[1] (1986) (discussing continental legal systems).

However, the concept of discharge is not new. During the reign of Queen Anne the concept entered the English law.⁴ Anne, ch. 17 (1705). The intent for such legislation has been viewed as an incentive for the debtor to cooperate with his creditors. Cohen, *supra*, at 156-57. Some form of discharge has been a part of every bankruptcy statute in American, although the scope has varied. See generally C. WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* (1935) (hereinafter C. WARREN, *BANKRUPTCY HISTORY*).

58. By putting the result in these stark terms one can easily see that developing a moral

system that gives creditors access to any of the assets of the debtor, or which would not discharge all debts, would surely detract from a policy of an absolute fresh start.⁵⁹ Should fresh start protect only those debtors who suffer some unavoidable or unexpected financial reversal leading to insolvency? Should it protect debtors who incorrectly predict their outlays and their income? Or, should it be broader and protect any debtor who seeks refuge under the law? In spite of these apparent ambiguities, the scholarly approach should not be to disregard this concept as inadequate,⁶⁰ but to recognize that this term is merely a shorthand rendition for the underlying values which encompass the congressional justification for debtor financial relief. The task then should be to focus on a determination of what that justification is and what values are reflected in the legislative implementation of the fresh start policy. In approaching this task, the inability, or perhaps the unwillingness, of most courts or lawyers to address legal issues in ethical or moral terms⁶¹ has impeded the achievement of the objectives of the fresh

justification for the process is a reasonable way to approach the problem. *But see* H. ARENDT, *THE HUMAN CONDITION* 243 (1958) ("forgiving . . . has always been deemed unrealistic and inadmissible in the public realm.").

59. On the other hand, fewer limitations on discharge arguably can create a "head start." *See* *Lines v. Frederick*, 400 U.S. 18, 21 (1970) (Harlan, J., dissenting) (asserting that accrued vacation pay was property of bankrupt estate and that Court's decision holding to contrary gave "head start").

60. *But see* Howard, *supra* note 20, at 1048 (arguing that fresh start formulation does not specify the goals of bankruptcy sufficiently to distinguish debts and debtors that should be discharged from those that should not). This statement can be viewed as reflecting the author's misunderstanding of the fresh start *policy*. The Congressional purpose behind the fresh start policy is to obtain debtor financial relief. Discharge and exemptions are statutory methods adopted by Congress to implement that policy and are designed to attain certain *goals*, *i.e.*, financial rehabilitation through the freeing of human capital and protection of the debtor and his family, among others. A *justification* for the fresh start *policy* should reflect the *values* that Congress was seeking to achieve or promote through the implementation of its policy. Thus, if the *goals* attained by the *policy* are ones which support the inherent *values* of the *policy*, there is a justification.

As seen in this light, the problem is not in the phrase "fresh start," but in the failure of commentators and courts to acknowledge the central moral justification for the fresh start *policy* and the *values* inherent in that policy. The failure to make such an acknowledgment is apparent in their writings. Howard, for example, notes five different and allegedly mutually inconsistent *policies* that justify isolated aspects of the Code's discharge rule. *Id.* at 1048. Hallinan states that there is a need to integrate the "disparate strands of the 'fresh start' into a coherent and integrated account of the debtor-relief objectives of bankruptcy as they exist under the Code." Hallinan, *supra* note 3, at 97.

61. *See* Rice, *Some Reasons for a Restoration of Natural Law Jurisprudence*, 24 *WAKE FOREST L. REV.* 539 (1989). Professor Rice eloquently notes that:

a wider recognition of the natural law as part of the law of God would serve as an incentive to the enactment of just laws as well as a brake on the enactment of unjust ones. However, arguments based on the natural law and the divine law will have little effect in a society that recognizes neither. It is not enough to argue the natural law case in academic terms. A restoration of societal respect for that law and for the divine law—a conversion—is needed before the natural law case will prevail in

start policy. It is time, however, to get serious about fresh start.

Any normative justification for debtor financial relief needs to explain, in terms of the values underlying the policy, the reasons for the protection of human capital, or, for that matter, the protection of any assets of the debtor. In addition, the normative justification for debtor financial relief needs to differentiate logically between the alienability of exemptions and the inalienability of the right to discharge.⁶² Finally, such an approach must explain the circumstances under which an individual may lose his right to discharge,⁶³ or may lose that right with respect to a particular debt.⁶⁴ The moral justification for debtor financial relief⁶⁵ has historical support and offers a satisfactory explanation for these as well as other questions.⁶⁶ This article now turns to these tasks.

Development of a Moral Justification for Debtor Financial Relief

The moral dimension of debtor relief has two separate but related facets. The first concerns the community's commitment to a debtor;⁶⁷ the second involves a debtor's commitment to his community.⁶⁸ An understanding

the public arena.

Id. at 569. Cf. Berman, *The Crisis of Legal Education in America*, 26 B.C.L. REV. 347, 348 (1985) (stating that "[o]nly the past two generations, in my lifetime, has the public philosophy of America shifted radically from a religious to a secular theory of law. . . .").

62. See Bankruptcy Code § 524(a) (stating that discharge cannot be waived). Under Sections 522(e) and (f), waivers of exemptions in exempt property are limited.

63. See Bankruptcy Code § 727(a) (listing situations when court shall deny discharge).

64. See Bankruptcy Code § 523(a) (listing nondischargeable debts).

65. Bankruptcy offers only *financial* relief for the individual debtor and, therefore, can be viewed as offering only one cog in the social policies of our country to promote social justice along with medicare and social security, among others. The process provides no debt counseling or consumer education to assist the individual from falling into the same economic trap. Furthermore, it does not prevent the imposition of criminal prison sanctions. See Pennsylvania Dep't of Pub. Welfare v. Davenport, 110 S. Ct. 2126, 2134 (1990) (Blackmun, J., dissenting). Justice Blackmun noted that the effect of the Court's holding (that restitution obligations were debts under the Code and dischargeable under Chapter 13) might force sentencing courts to impose a harsher and less appropriate term of imprisonment, "a sentence that the federal bankruptcy courts will be unable to undermine." *Id.* at 2138.

66. See *infra* text accompanying notes 125-81.

67. Little academic scholarship has discussed this fundamental principle intrinsic to the bankruptcy process. In one of the few recent discussions of a potential moral dimension of fresh start policy the focus lay only on the debtor's moral obligation to pay his creditors. See Hallinan, *supra* note 3, at 138-43. According to Hallinan, "Moral judgments may provide a basis for creating or increasing incentives to avoid particular conduct, but it is the existence and quality of the incentives, rather than the moral judgment, that determines the availability of relief." *Id.* at 139. Although acknowledging an "undeniable rhetorical significance" of the language of moral rights, Hallinan rejects moral norms as an explanation for the fresh start policy because he finds it incompatible with his "economic approach". *Id.* at 141-43. See also Ayer, *How to Think About Bankruptcy Ethics*, 60 AM. BANKR. L.J. 355, 371 (1986) (stating that policies underlying discharge provide little support or contradiction for notion that independent moral obligation to pay one's debts may exist).

68. These commitments are mutually interdependent, as the community is but the sum

of the moral dimension of debtor financial relief can lead to a natural law method for developing a moral justification for the debtor financial relief provisions of the Bankruptcy Code. Natural law method is a decision-making process relying first on the use of practical reason to develop a field of choices among a field of human goods or values. Then, the method uses moral principles to assist in the choosing among those goods or values.⁶⁹ Moral reasoning requires that in giving a justification, an individual must connect descriptions of that conduct with a principle or value, that is, the ultimate reason for the action.

Asserting that there is a moral justification⁷⁰ for the debtor financial relief provisions of the Code means that it is completely reasonable for Congress to legislate conditions for the forgiveness of debt between autonomous individuals.⁷¹ The use of the term "reasonable" signifies that our

of all its individuals. Thus, the community's well-being is enhanced by the individual well-being of all its members just as the community's well-being is diminished if the well-being of any of its members is diminished. The common good is not just the greatest net good under a utilitarian theory. *But see* Shuchman, *supra* note 29, at 410 (suggesting that "the purpose of this body of law [bankruptcy] ought . . . to be the accomplishment of as much good and as much utility as possible. . .").

The focus should be not on the "size of the pie," but on the equitable distribution of that pie among the members of the community. Institutions, or for that matter laws, exist for individuals in the community, and an individual should not be harmed so that others may prosper or so that the system may work. The grounding of this common good can be in God's intentions, or, under the approach presented in this article, the use of the principles of practical reasonableness. "The ideal of integral human fulfillment is that of a single system in which all the goods of human persons would contribute to the fulfillment of the whole community of persons." G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 185. The idea of common good however is not the fulfillment of the community's goals, but is "fundamentally the good of individuals (an aspect of whose good is friendship in the community)." J. FINNIS, *NATURAL LAW*, *supra* note 23, at 168; G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 270-73.

69. J. FINNIS, *NATURAL LAW*, *supra* note 23, at 23. Any theory of natural law "undertakes a critique of practical viewpoints, in order to distinguish the practically unreasonable from the practically reasonable. . . . [It] claims to be able to identify conditions and principles of practical right-mindedness, of good and proper order among men and in individual conduct." *Id.* at 18. Moral principles are those principles concerned with the establishment and maintenance of proper social relations among persons with respect to the basic human goods or values. *Id.* The supposed authority of these human goods can come from religious beliefs. G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 134-35.

70. The use of reason is required to translate the natural inclinations to obtain human ends into practical decisions and actions. It is in the making of these decisions and in the offering of justifications for them that one enters into the realm of morals. *See* H. ARKES, *FIRST THINGS* 13 (1986). *See* Hittinger, *Minimalist Theory*, *supra* note 22, at 141-42 (1989). Finnis and Grisez refer to these as basic human goods. J. FINNIS, *NATURAL LAW*, *supra* note 23, at 85-90; G. GRISEZ & R. SHAW, *BEYOND THE NEW MORALITY* 79-83 (3rd ed. 1988) [hereinafter G. GRISEZ, *NEW MORALITY*].

71. By asserting that the present system has a moral justification does not mean that another system also may not be morally justifiable. Assuming that another scheme satisfies the conditions as detailed below, it also may satisfy the natural law method of being reasonable. The analysis that follows is, thus, a positive approach to the existing statutory scheme. A normative approach suggesting legislative changes hopefully will be the subject of further research by other academicians.

present system, which frees human capital, provides for exemptions, and imposes certain limitations upon discharge and dischargeability, is consistent with the fulfillment of the common good under the principles of the natural law method originally pronounced by Saint Thomas Aquinas.⁷² Under the approach of Aquinas natural law is a rule of reason for the common good, made by God and intrinsic in man, which provides a ground for decision and action. Human law, which is derived from natural law, is an integral part of God's plan and is designed to promote the common good and help man achieve his highest good. Recently, Germain G. Grisez and John Finnis have expanded and restated Aquinas' natural law method.⁷³

One of the central features of the Grisez-Finnis moral theory is "its account of ultimate reasons for action."⁷⁴ That is, that the ultimate reason for human action must be made in reference to some intrinsic human good

72. The approach taken in this article is similar to the approach of Saint Thomas Aquinas, who postulated that the way to discover what was morally right was to investigate what was reasonable. "[M]an's good is to be in accord with reason, and his evil is to be against reason. . . ." T. AQUINAS, *SUMMA THEOLOGICA* I-II q. 71, a. 2 (Benziger Brothers ed. 1947). See also G. GRISEZ, *NEW MORALITY*, *supra* note 70, at 97 (stating that "[t]o be morally good is to be completely reasonable, to be morally bad is to be somewhat less than completely reasonable.") (emphasis in original). Law as defined by Aquinas is "an ordinance of reason for the common good, made by him who has care of the community, and promulgated." T. AQUINAS, *supra*, at I-II, q. 90, a. 4. Law is a directive for activity which presupposes a choice which must itself be in accord with moral principles if the directive is to be law with moral force. *Id.* at I-II, q. 96, a. 4. Thus, for Aquinas all law (Aquinas distinguishes four types of law: eternal law, natural law, human law, and divine law (*Id.* at I-II, q. 91, a. 1-a. 4)) must have a moral foundation. *Id.* at I-II, q. 93, a. 3. *Id.* at I-II, q. 90, a. 1. Aquinas states that the basic principles of natural law are "instilled it into man's mind so as to be known by him naturally." *Id.* at I-II, q. 90 a. 4. For a more detailed discussion and explanation of Aquinas' Treatise of Law, see L. WEINREB, *NATURAL LAW AND JUSTICE* 53-63 (1987); Rice, *supra* note 61, at 558-66.

73. See J. FINNIS, *NATURAL LAW*, *supra* note 23; G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23; G. GRISEZ, *NEW MORALITY*, *supra* note 70. Grisez acknowledges his difference from other interpreters of Aquinas by asserting that the first precept of natural law ("good is to be done and pursued, and evil is to be avoided") does not refer to a moral imperative but refers only to the manner by which one chooses between human goods or values. Grisez, *The First Principle of Practical Reason: A Commentary on Summa Theologiae, I-2, Question 94, Article 2*, 10 NAT. L.F. 168, 200 (1965). Grisez asserts that the "principle is not an imperative demanding morally good action. . . . [p]recisely because the first principle does not specify the direction of human action, it is not a premise in practical reasoning; other principles are required to determine direction." *Id.* Finnis acknowledges that his ethical theory is "squarely based" upon Grisez. J. FINNIS, *NATURAL LAW*, *supra*, at vii [hereinafter this theory will be referred to as the Grisez-Finnis approach].

This interpretation of Aquinas has been attacked as a total misstatement or misunderstanding of Aquinas' position. See R. HITTINGER, *supra* note 22, at 30-39. Hittinger asserts that Grisez is not being true to the Thomistic texts and only wants to create his own version of a system of natural law founded on two separate components: a first principle of practical reason, which guides practical reason in a premoral state; and a first principle of morality which stipulate the specific moral principles of choice. See Hittinger, *Minimalist Theory*, *supra* note 22, at 159-61.

74. George, *Recent Criticisms of Natural Law Theory*, 55 U. CHI. L. REV. 1371, 1407 (1990).

or value⁷⁵ that renders the choice intelligible, having some purpose. The first principle of practical reason—that good should be done⁷⁶—guides action by reference to moral norms⁷⁷ that provide a standard for fully reasonable choices compatible with individual human fulfillment.⁷⁸ The essence of this

75. In his work, Grisez explains that the term “human goods” does not mean property or other things extrinsic to persons, but are aspects of the person himself. His list of goods includes: self-integration, practical reasonableness, authenticity, justice, friendship, religion, knowledge, appreciation for beauty, and play. G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 123-24. Finnis categorizes the basic human goods or values as: life (and health), knowledge, play, aesthetic experience, sociability (friendship), practical reasonableness, and religion. J. FINNIS, *NATURAL LAW*, *supra* note 23, at 85-90. These goods are intrinsic and are the reasonable basis for action. See George, *supra* note 74, at 1392. In his article George gives a rather detailed illustration of the chain of practical reason that traces back to an ultimate good or value. *Id.* at 1390-94.

76. T. AQUINAS, *supra* note 72, at I-II, q. 94, a. 2 (according to Aquinas, natural law is directed to common good through first principle of natural law: “[G]ood is to be done and pursued, and evil is to be avoided.”). Grisez and Finnis refer to this as the first principle of practical reasonableness. See J. FINNIS, *NATURAL LAW*, *supra* note 23, at 100; G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 178. Under the Grisez-Finnis theory even an immoral act can respond to this principle.

Even morally bad actions have their point. One chooses to do what is morally wrong for some reason, and like any other deliberate action, the reason for which one acts immorally must ultimately be reduced to the basic goods. So far forth, even an immoral act responds to the first principle: Good is to be done and pursued.

Grisez, Boyle, & Finnis, *Practical Principles, Moral Truth, and Ultimate Ends*, 32 *AM. J. JURIS.* 99, 121 (1987) [hereinafter Grisez, Boyle, & Finnis, *Moral Truth*]. *But see* Hittinger, *Minimalist Theory*, *supra* note 22, at 160 (noting that if Grisez and Finnis had not dropped second part of principle—that evil is to be avoided—it would have been “senseless” to speak of this principle as pre-moral).

77. Because the first practical principle does not state a moral principle, Grisez and Finnis develop the first principle of morality by which persons are enjoined to “choose and otherwise will [choose] those and only those possibilities whose willing is compatible with a will toward integral human fulfillment.” Grisez, Boyle, & Finnis, *Moral Truths*, *supra* note 76, at 128. “The ideal of integral human fulfillment is that of a single system in which all the goods of human persons would contribute to the fulfillment of the whole community of persons.” G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 185. It is not the individual satisfaction of desires that is the ultimate goal, but the realization of all the human goods in the whole of human community. They postulate eight moral principles to structure and guide human choices between intelligible human goods to achieve ultimate human fulfillment. Finnis labels these “requirements of practical reasonableness.” J. FINNIS, *NATURAL LAW*, *supra* note 23, at 100-127. Grisez refers to these principles as the “modes of responsibility.” G. GRISEZ, *NEW MORALITY*, *supra* note 70, at 117-39. These requirements constitute a natural law method by giving the “sorts of reasons why (and thus the ways in which) there are things that morally ought (not) to be done.” J. FINNIS, *NATURAL LAW*, *supra*, at 103. These principles “specify the ways of choosing and acting which are incompatible with respect for and service of the goods.” G. GRISEZ, *NEW MORALITY*, *supra*, at 118. It is through the interrelationship of these moral principles and the first principle of natural law that human choices and actions are guided in respect to intrinsic human goods. *Id.* Under their theory, although not all the modes are equally important, “[m]oral goodness means service of all the human goods and observance of all the modes.” *Id.* at 127.

78. See G. GRISEZ, *NEW MORALITY*, *supra* note 70, at 103-04 (noting that first principle of morality under Grisez-Finnis theory refers to ideal of integral human fulfillment). Our

approach in evaluating positive law, such as the Bankruptcy Code, is: whether the law provides for basic human goods or values determined under requirements of practical reasonableness, and whether the process of choosing between the various human goods or values was done in a manner consistent with integral community fulfillment.⁷⁹ If these requirements are fulfilled, the law is morally justified, or "reasonable."⁸⁰

Given this basic overview of the Grisez-Finnis moral philosophy, one can apply the natural law method to develop a moral justification for debtor financial relief. This application requires the resolution of the following questions: What values or human needs are being protected by the law? Are the provisions of the law consistent with the application of the requirements of practical reasonableness? Does the Code assist the nation in moving toward social justice for all members, individually, and collectively as a society?⁸¹

knowledge of this ideal comes from practical reason, but it cannot be achieved by human choices. However, as noted by George, the norms derived from the first principle of morality direct our choices to things that can be done. "We cannot choose to bring about integral human fulfillment, but we can choose compatibility with a will to integral human fulfillment." George, *supra* note 74, at 1420.

79. According to Finnis a positive regulatory law like the Bankruptcy Code should be grounded in principles of practical reasonableness (moral principles) and should give "due respect for the human rights which embody the requirements of justice, and for the purpose of promoting a common good in which such respect for rights is a component." J. FINNIS, *NATURAL LAW*, *supra* note 23, at 23. Finnis illustrates his requirement of justice by using the English Bankruptcy Law as an example. *Id.* at 188-93. The purpose of his approach is to first identify human goods that can be secured only through institutions of human law. *Id.* at 3. Then he uses the requirements of practical reasonableness to determine if that human law is justified in the manner that it approaches the attainment of human goods. *Id.*

80. While the majority of the work of Germain Grisez is centered in the moral philosophy for individual choice, Grisez does realize that in evaluating social structures and policies (which is the goal of this article), the issue of the common good arises. "When one speaks of the common good as a moral principle, one is speaking, from a communal perspective, of the basic human goods, while the social morality flowing from this source depends on the modes of responsibility viewed and applied in a social context." G. GRISEZ, *NEW MORALITY*, *supra* note 70, at 163. He notes that there are two situations in which the common good would be superior to the good of the individual:

First, the intelligible human goods are superior to the good as it is experienced by any one person: it is more important that the good be respected and realized than that I get my little share of it. Second, the fulfillment of the group cooperative action takes priority over unfair individual satisfaction.

Id. at 164. *Cf.* Office of Personnel Management v. Richmond, 110 S. Ct. 2465, 2473 (1990) (holding that erroneous advice given by governmental employee to benefit claimant cannot estop Government from denying benefits not otherwise permitted by law). The Supreme Court noted that the purpose of the Appropriations Clause of the Constitution was to "assure that public funds will be spent according to the letter of the *difficult judgments reached by Congress as to the common good*, and not according to individual favor of Government agents or the individual pleas of litigants." *Id.* (emphasis added).

81. See G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 280 (providing that regulatory "[c]ivil law provides a public facility for regulating private affairs according to the public purpose of mutual justice and common peace"). In response to the skeptic, Finnis notes that

The debtor relief process can be viewed as congressional recognition that the intrinsic value of human dignity dictates that a debtor be given an opportunity to earn a living.⁸² The freeing of human capital provides an individual debtor with the ability to maintain a minimum standard of living and puts him back on the road to self-determination. Thus, discharge is an acknowledgment by Congress that the dignity of the individual person has value. The congressional reaffirmation of that value by the granting of a discharge replaces dejection with hope.⁸³ The discharge also reflects an awareness that the productive resources of every individual are significant, and that by releasing the debtor from his past financial obligations, his renewed vigor will benefit society as a whole as well as himself. The forgiveness of debt also has a rehabilitative, salutary effect as an admission on the part of a debtor of his own inability to remedy past mistakes, and the need to move forward with a more rational life plan.⁸⁴

Exemptions, which are the other major aspect of fresh start,⁸⁵ represent the humanitarian response of society to an individual debtor.⁸⁶ Exemptions

the "traditions of natural law theorizing" show that a decision of "positing law" should be guided by moral principles that are "a matter of objective reasonableness, not of whim, convention, or mere 'decision.'" J. FINNIS, *NATURAL LAW*, *supra* note 23, at 290. See also Hittinger, *Liberalism and the American Natural Law Tradition*, 25 WAKE FOREST L. REV. 429, 498 (1990) [hereinafter Hittinger, *Liberalism*] (listing four criteria for judicial use of natural law in constitutional interpretation).

82. See G. GRISEZ, *MORAL PRINCIPLES*, *supra* note 23, at 137-39 (discussing bodily life as one of basic human goods or values).

83. The importance of the discharge to maintain and preserve human dignity can itself support its nonwaivability strictly on moral grounds. *But see* T. JACKSON, *LOGIC AND LIMITS*, *supra* note 37, at 253-80 (arguing that non-waivability of discharge arises as a response to weaknesses in human nature that create impulses and bias).

84. See J. FINNIS, *NATURAL LAW*, *supra* note 23, at 103-05 (discussing coherent life plan as one of eight basic requirements of practical reasonableness); Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 726 (1980) (stating that discharge has been said to "liberate the bankrupt psychologically").

Congress in effect has given its stamp of approval to alleviate some of the supposed guilt felt by a debtor in extinguishing of legal obligations to pay while the moral obligation remains. The individual's recognition of this moral obligation to repay might be one of the non-monetary reasons for postponing the filing decision. However, Congress in enacting the Code has left this decision to the debtor, while offering him an alternative out of society's largess of human kindness. See F. NOEL, *supra* note 18, at 191-200 (discussing whether the passage of bankruptcy legislation can eradicate even the moral obligation to pay).

85. See COMMISSION REPORT, *supra* note 21, at 109, 169; Countryman, *supra* note 15, at 818 (providing that "[o]bviously, the debtor's future wages were essential to his 'fresh start' but the exemptions he was allowed to retain from his existing estate were also a significant element in the measurement of the extent of that fresh start.").

86. See Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615, 621 (1978) (asserting that exemptions should further one of five social policies). These five social policies are:

- (1) To provide the debtor with property necessary for his physical survival;
- (2) To protect the dignity and the cultural and religious identity of the debtor;
- (3) To enable the debtor to rehabilitate himself financially and earn income in the future;

give a debtor the basic necessities of life and place the debtor back on track for the reconstruction of his financial life. Exemptions reflect what an individual's community, represented by state legislature or Congress, believes is necessary for the individual good.⁸⁷ The exemption of certain property from execution also benefits society as a whole by preventing debtors from becoming public charges.⁸⁸ Furthermore, exempt property provides the basic needs for a debtor's dependents, mirroring an acknowledgment by Congress of the important value of preserving of the integral family unit.⁸⁹ The family unit should not suffer the consequences of financial mistakes in which it did not directly participate.⁹⁰ Exemptions are steeped in principles of social justice and exemplify an awareness that the distribution—or for that matter the redistribution—of wealth in our nation should insure that each individual's very basic needs are met.⁹¹ The retention of some minimum level of assets, freed from one's general creditors, is in fact the ultimate humani-

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- (4) To protect the debtor's family from the adverse consequences of impoverishment;
(5) To shift the burden of providing the debtor and his family with minimal financial support from society to the debtor's creditors.

Id. Each of these social policies are but a recognition of the underlying humanitarian value which is the foundation of our exemption laws. *Id.*

87. See J. FINNIS, *NATURAL LAW*, *supra* note 23, at 225 (stating that "the basic values are not mere abstractions; they are aspects of the real well-being of flesh-and-blood individuals."); Warren, *Reducing Bankruptcy Protection for Consumers: A Response*, 72 *Geo. L.J.* 1333, 1356 (1984) (positing that "[w]ith adequate exemptions in place, the bankruptcy statutes permit the working poor who have become hopelessly mired in consumer debt to begin again the climb into the middle class with some assets intact.").

88. See *HOUSE REPORT*, *supra* note 52, at 126, *reprinted in* 1978 *U.S. CODE CONG. & ADM. NEWS* at 6087 (stating that "[t]he historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge.").

89. See, e.g., *Allen & Co. v. Ferguson*, 85 U.S. (18 Wall.) 1 (1873) (discussing issue of whether promise that was clear and unequivocal was sufficient to revive discharged debt). By way of dicta in discussing what would be "right" in a particular situation, the Court noted that "[n]either the supreme will, so far as we can ascertain it, nor the laws of the land, require that a debtor whose family is in need, or who is himself exhausted by a protracted struggle with poverty and misfortune, should prefer a creditor to his family." *Id.* at 4. Part of the moral obligations flowing from living in a family relationship is the duty to provide for those members of the family unit. By entering into a family relationship one has made a commitment and one should respond to that commitment out of fidelity, and should not abandon the commitment lightly.

90. By permitting the family to suffer one would be ignoring a Grisez-Finnis requirement of practical reason. The third rule of practical reasonableness equates to the "Golden Rule": "Do to (or for) others what you would have them do to (or for) you." See J. FINNIS, *NATURAL LAW*, *supra* note 23, at 107-08. There is no reason to deprive the debtor's family of what its community articulates as a subsistent level. See also J. RAWLS, *A THEORY OF JUSTICE* 14-15 (1971). Rawl's contractarian theory of justice as fairness should reach the same conclusion under his difference principle. Thus, inequalities are justified if they "result in compensating benefits for everyone, and in particular for the least advantaged members of society." *Id.*

91. See Shuchman, *supra* note 29, at 439.

tarian response of the community to a debtor, and this response is firmly rooted in reason.⁹²

Conversely, when a debtor fails to comply with certain societal norms as reflected in the legislative choices, he faces the possibility that certain benefits of the bankruptcy process, including discharge and the dischargeability of certain debts, may be denied. In the case of discharge, Congress in large part has made choices that acknowledge an awareness of the moral dimension.⁹³ For example, Congress has identified certain conduct that adversely affects efforts to discover and collect assets for distribution to creditors, such as destruction or concealment of property and has prohibited discharge in light of such conduct.⁹⁴ In these situations, a debtor's conduct has a significantly adverse effect on the other major policy of consumer bankruptcy—that of distributing the consequences of debtor defaults among his respective creditors.⁹⁵ In these circumstances, principles of social justice impose restrictions upon the rights of an individual debtor, and he must accept the responsibility for his own misconduct under the Grisez-Finnis theory.⁹⁶ Thus, it is reasonable that Congress, after weighing the competing interests of the two policies, has determined that as a result of certain conduct a debtor may lose the largess of the nation. How egregious the conduct of the debtor must be before the fresh start policy is modified by the debt collection and distribution policy is a matter to be weighed by the elected officials of the nation, who in theory represent the collective moral

92. See COMMISSION REPORT, *supra* note 21, at 172 (noting "the policy underlying exemptions, that is, that the debtor not be left destitute and have a basis for rehabilitation"). Some level of exempt property is justified under a "sane method of natural law theory". See Hittinger, *Liberalism*, *supra* note 81, at 498 (stating that "Convergent lines of enquiry, following the paths of institutional and historical experience as well as that of philosophical reflection, represent the sane method of natural law theory."). The nature and type of exempt property have always been the subject of debate. However, the inability of a debtor to have any exemptions would be morally repugnant. Exempt property forms a base line of economic protection for the poor.

93. In only one instance does the decision of Congress appear to be purely arbitrary. Bankruptcy Code § 727 (a)(8),(9) (limiting access to discharge in personal bankruptcy to once every six years). There appears to be no real moral justification for such a rule, for it assumes that an individual who seeks a discharge is "bad," without any identification of the values underlying the decision. See Shuchman, *supra* note 29, at 474 (noting that there is no moral or economic basis for such action).

94. See Bankruptcy Code § 727(a)(2)-(7) (listing debtor conduct such as destruction, mutilation, or concealment of property, which will cause denial of debt discharge).

95. See Warren, *supra* note 16, at 777 (expressing view that "no one value dominates, so that bankruptcy policy [in the context of business bankruptcy] becomes a composite of factors that bear on a better answer to the question, 'How shall the losses be distributed?'); see also Baird, *supra* note 16, at 816 (discussing collection efforts of creditors within state created property rights system that requires creditors to work within moral framework of bankruptcy system).

96. See J. FINNIS, NATURAL LAW, *supra* note 23, at 183-84 (discussing debtor's responsibilities in system of commutative justice). Finnis stressed the individuals' responsibilities of fairness to other known or unknown individuals and to the governing authorities.

judgments of the nation.⁹⁷ Consequently, when one talks of fresh start policy, one needs to be cognizant that an underlying value justifying that policy requires active, productive, and honest debtor dealings with the courts and creditors.

It is reasonable to suppose that Congress has identified certain ethical values that support its selection of nondischargeable financial obligations.⁹⁸ In actuality, the congressional designation is a mixed bag which generally can be viewed as punishing the "unworthy debtor" and protecting the "worthy creditor". However, certain nonethical values also form the foundation for congressional selection of some nondischargeable debts. Thus, the application of a moral justification in the area of dischargeability does not always lead to obvious concrete solutions, nor simple answers to resolving all disputes. But the approach can raise the level of consciousness in decision-making by forcing the decision-maker to acknowledge that no single talisman will facilitate his job, which in turn should help develop a deeper understanding of the process.⁹⁹

There are basically three separate and distinct general classifications of debts that are subject to nondischargeability. The first classification involves obligations to former spouses and children.¹⁰⁰ This type of debt is most sacred under the Code, being nondischargeable in all consumer proceedings.¹⁰¹ The moral responsibility of the debtor to provide economic support for his family is beyond question, and the exception can be explained under the moral theory posited here as a response to the humanitarian needs of the family.¹⁰² The underlying ethical commitment to one's family was recognized by the courts even before the Act was amended in 1903 to specifically except such obligations from discharge.¹⁰³

97. See, e.g., Hittinger, *Liberalism*, *supra* note 81, at 498 (asserting that "the natural law claim ought to comport with the tradition and conscience of the people").

98. Cf. T. JACKSON, *LOGIC AND LIMITS*, *supra* note 37, at 278 (stating that "questions of the nondischargeability of particular debts should be analyzed against what bankruptcy law is trying to do through its fresh-start policy").

99. *But see* Howard, *supra* note 20, at 1057 (asserting that ethical considerations result in no help to the decision maker). However, even Howard acknowledges that her functional approach is riddled with normative propositions. She overlooks the "weakness" of her subjective value judgments to reach her ad hoc economic justification for discharge. *Id.* at 1088.

100. See Bankruptcy Code § 523(a)(5).

101. See Bankruptcy Code §§ 523(a), 1328(a).

102. The basis of this exception to discharge is the "universal sentiment" favoring obligations to family. See H.R. REP. NO. 1698, 57th Cong., 1st Sess. (1902) (reprinted in *EASTMAN, THE BANKRUPTCY LAW ANNOTATED* 409 (1903) (hereinafter 1902 HOUSE REPORT)).

103. See *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904) (stating that "[t]he bankruptcy law should receive such an interpretation as will effectuate its beneficent purposes and not make it an instrument to deprive dependent wife and children of the support and maintenance due them from the husband and father, which it has ever been the purpose of the law to enforce."). In *Wetmore* the Supreme Court based its decision on both legal and moral obligations. *Id.* See also *Dunbar v. Dunbar*, 190 U.S. 340, 352 (1903); *Audubon v. Shufeldt*, 181 U.S. 575, 580 (1901).

The second general classification of debts that are excepted from discharge are those debts owing to governmental units and student loans made, insured or guaranteed by a governmental unit.¹⁰⁴ Little if any moral justification can be leveled to support the nondischargeability of tax liabilities.¹⁰⁵ The result appears to be more or less the result of the superior political power of governmental units. On the other hand, the nondischargeability of student loans can be viewed as promoting meaningful and significant values.¹⁰⁶ Under the Grisez-Finnis ideal of commutative justice, there is a duty imposed upon an individual to be accountable for benefits bestowed on him by a government.¹⁰⁷ Thus, the failure to repay a student loan, which might result in increased costs for others or severely restrict the availability of future funds, could be a sufficient ethical reason to deny discharge of that debt.¹⁰⁸ In terms of distributive justice concerns that individual needs be met, however, significant ethical reasons exist to grant discharge of such debts. Congressional authorization for courts to grant a discharge of student loan obligations in the event that repayment might cause undue hardship¹⁰⁹ reflects the proper balance of the competing values of commutative justice and distributive justice in that it does not show a preference of one set of values over the other.

Unacceptable conduct by the debtor in his dealings with creditors comprises the remaining classification of nondischargeable debts. These

104. See Bankruptcy Code §§ 523(a)(1), (8).

105. See, e.g., Howard, *supra* note 20, at 1058 (asserting that "the government, just because it is the government is a favored creditor).

106. See COMMISSION REPORT, *supra* note 21, at 177 (stating that nondischargeability of these debts was necessary because rising number of bankruptcies by students who had such loans posed "threat to the continuance of educational loan programs"). H.R. 8200 did not contain an exception for educational loans, but the Senate provision as modified became the original § 523(a)(8). As enacted in 1978, it did not cover loans guaranteed by the government. Efforts to amend it were immediate and successful in maintaining "the credibility and stability of the student loan program and assure that future generations of students will have a viable loan program available to them." S. REP. No. 230, 96th Cong., 2d Sess. 3 (1979), reprinted in 1979 U.S. CODE CONG. & ADMIN. NEWS 938.

107. Cf. Sullivan, Warren & Westbrook, *Limiting Access*, *supra* note 18, at 1137 n.283 (stating that "[w]hile it may not be clear that student discharges were so serious a problem as to require denial of the discharge, at least the provision was a particularized response to a perceived abuse.").

108. See J. FINNIS, NATURAL LAW, *supra* note 23, at 184 (arguing that "[a]n individual who abuses, exploits, or 'free-rides' on some system which is advantageous to himself and to others, knowing that his abuse may bring about the limitation or abandonment of the scheme, is commutatively unjust to all those who might in future have enjoyed the benefits of the original scheme."). The congressional decision of making student loans nondischargeable relies upon certain economic assumptions that may not be empirically accurate. Furthermore, the increased human potential of an individual may more than offset the alleged economic losses due to the failure to make the loan repayment. Once again, this exemplifies problems that may be created by using economic analysis in an imperfect world. See, e.g., Howard, *supra* note 20, at 1087 (asserting that no economic justification exists for nondischargeability of student loans).

109. See Bankruptcy Code § 523(a)(8)(B).

debts include obligations which are founded in fraud, false financial statements, willful torts, and breach of fiduciary duty, among others.¹¹⁰ It is in these areas that the underlying ethical values are most obvious.¹¹¹ Congressional emphasis is not on the normative proposition that debts should be paid,¹¹² but on the degree of fairness in one's dealings with others. This is not to say that other congressional decisions on the mix of nondischargeable debts could not be morally justified, but only to say that there is a moral justification underlying this classification of nondischargeable debts.

It is in resolving issues in this last classification of nondischargeable debts that the mutual covenant relationship between an individual and society implicit in the Grisez-Finnis ideal of commutative justice is most apparent. In order to receive the "gift" of debt forgiveness from the community, one must deal with his creditors (who make up the community) in an unobjectionable manner. To flatly reject this approach as vague and too subjective for decision-making only reflects the desire for simple concrete answers. Once again, it is not the purpose of this article to develop solutions to all possible issues by uncovering and exposing the moral justification for fresh start policy, but only to encourage others to acknowledge that such a justification should be considered in any decision-making.¹¹³

The exceptions to discharge are all but emasculated by Chapter 13.¹¹⁴ The distinction between the broader discharge under Chapter 13 in which only family obligations and taxes remain nondischargeable¹¹⁵ rests upon

110. See Bankruptcy Code §§ 523(a)(2), (4), (6), (7), (9).

111. See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (stating that equitable powers of bankruptcy court can only be exercised within confines of Code itself). The Grisez-Finnis approach is not limited to a simple maxim such as, one who by his actions has not done equity, should not expect equity in return, but does rely upon basic concepts of equity in the application of moral principles.

112. Shuchman, *supra* note 29, at 469.

113. Cf. F. NOEL, *supra* note 18, at 189-90 (observing that through provisions limiting right to discharge and providing for nondischargeability of certain debts, Congress has "the key to the efficiency of the system and through it, as a control valve, the courts are able to bring moral censorship to bear on the conduct of all debtors, and by this method a high standard of commercial integrity is encouraged and maintained").

114. The difference between the scope of discharge under Chapters 7 and 13 can be explained in part by an understanding that the principles of distributive justice, society's commitment to the debtor, outweigh the principles of commutative justice, in that the individual has offered to recompense those he has wronged through payments under a plan. See, e.g., *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 110 S. Ct. 2126, 2133 (1990).

[T]he dischargeability of debts in Chapter 13 that are not dischargeable in Chapter 7 represents a policy judgment that [it] is preferable for debtors to attempt to pay such debts to the best of their abilities over three years rather than for those debtors to have those debts hanging over their heads indefinitely, perhaps for the rest of their lives.

Id. (quoting 5 COLLIER ON BANKRUPTCY, para. 1328.01[1][c] (15th ed. 1986)) (footnote omitted).

115. Under chapter 13 debts grounded on fraud, (§ 523(a)(2)), on breach of fiduciary obligation, embezzlement or larceny, (§ 523(a)(4)), willful and malicious injury to person or property, (§ 523(a)(6)), fines and penalties, (§ 523(a)(7)) and student loans (§ 523(a)(8)) are discharged upon completion of the plan. Bankruptcy Code § 1328(a). However, the fact that

strong ethical considerations. If a debtor is willing to expend all or a portion of his disposable income¹¹⁶ to the repayment of his financial obligations over a three year period of time,¹¹⁷ he is entitled to the broader discharge. The debtor's recognition and acceptance of responsibility, through repayment of all or a part of his debts, including otherwise nondischargeable debts, from future income reflects repentance—the acknowledgment of an obligation and the effort to rectify it. This normative value underlies the moral justification for the broader discharge under Chapter 13.¹¹⁸ Viewed in this light, the economic effects or results of the broader discharge pale in significance to the humanitarian treatment of the repentant debtor whose actions in repayment are imbued in principles of practical reason under the Grisez-Finnis approach.¹¹⁹

Fresh start policy can be summed up as reflecting an acknowledgment by Congress of the validity of the first precept of practical reason that "good is to be done."¹²⁰ This policy achieves the ideal of the first principle of morality by placing the justification for the bankruptcy process on values of human dignity,¹²¹ humanitarianism, and fairness from the perspective of

many, if not most, Chapter 13 plans are not completed emasculates this broad grant of discharge. See T. SULLIVAN, *AS WE FORGIVE*, *supra* note 3, at 216 (detailing the empirical evidence that shows that most Chapter 13 plans are not completed).

116. See Bankruptcy Code § 1325(b)(1)(B) (requiring that upon objection by trustee or holder of allowed unsecured claim, court may not approve plan unless all debtor's projected disposable income is dedicated to plan). In defining disposable income the Code excludes income reasonably necessary for the maintenance or support of the debtor and his dependents. Bankruptcy Code § 1325(b)(2).

117. See Bankruptcy Code § 1322(c) (providing that court, for cause, can approve payments according to plan for period longer than three years). However, the Code further states that extended period may not be longer than five years.

118. If the payments are not made under the Chapter 13 plan a hardship discharge may be granted by the Court, but the extent of the discharge is severely limited. Bankruptcy Code § 1328(b), (c). The debtor receives a discharge similar to that under Chapter 7. Thus, the obligations listed as nondischargeable under § 523(a) remain. This of course creates an anomaly in that a Chapter 13 debtor who offers to pay his creditors more, but fails to complete his plan, might secure a hardship discharge, whereas one who offers less and completes his plan may receive the broader discharge. This result needs to be reconsidered by Congress in light of the values underlying a moral justification for the process.

119. *Cf.* Gross, *Preserving Fresh Start*, *supra* note 20, at 151-52 (suggesting that narrow interpretation of Consumer Credit Amendments including the changes in Chapter 13, reinforces other legal theories including antipeonage laws and other paternalistic protections).

120. *But see* Hallinan, *supra* note 3, at 139. Hallinan, like many other current bankruptcy scholars, is unwilling to accept the fact the morality can and does underlie this fundamental positive law and that it has a valid usefulness in assisting lawyers and judges make decisions.

121. See, e.g., House Report, *supra* note 52, at 173, *reprinted in* 1978 U.S. CODE CONG. & ADM. NEWS at 6134 (statement of David H. Williams, attorney, FTC) (stating that "[t]he consumer who seeks the relief of a bankruptcy court is an individual who is in desperate trouble."). According to the report, a bankrupt consumer "lacks the resources to meet his commitments and has no means at his disposal to rectify this situation. . . . [t]his individual is entitled to a focused and compassionate effort. . . . [r]elief should be provided with fairness to all concerned but with due regard to the *dignity of the consumer as an individual* who is in need of help.") *Id.* (emphasis added).

an individual and his community. Under principles of distributive justice,¹²² each individual in our society is entitled to a level of human dignity. In order to achieve that dignity the individual must be provided with a minimum level of subsistence¹²³ and the opportunity to provide for himself and his family without the burden of overwhelming debt. In return for the benefits provided by these exemptions, the values of individual fairness and responsibility inherent in commutative justice impose certain duties and obligations upon the debtor. The bankruptcy process recognizes that the economic consequences of credit should in most cases be thrown upon the credit participants.¹²⁴ Nevertheless, in those situations where the debtor has failed to meet the standards of fair-dealing, he faces the possibility that his debts will be declared nondischargeable.

The discharge and dischargeability issues in bankruptcy reflect the tension that exists between the elemental moral values inherent in commutative and distributive justice. In drawing the line, whether in legislation or in deciding hard cases, the ability to acknowledge and articulate these values can lead to a realization of the fundamental mutual covenants implicit in the legislation. The Code's emphasis on the values of human dignity, humanitarianism, and fairness reflect a true balancing of the competing interests of the debtor, the creditor, and society. Having developed an approach toward a moral justification for the debtor relief provisions of the Code, this article now examines the history of bankruptcy to determine if this moral justification has in fact been a part of that heritage.

Moral Justification of Debtor Financial Relief in a Historical Context

Only since the passage of the Bankruptcy Act in 1898 has bankruptcy had as a generally recognized independent purpose the restoring of a debtor to some level of human dignity to proceed in the future free from the

122. See, e.g., J. Finnis, *Natural Law*, *supra* note 23, at 161 (describing distributive justice as that "ensemble of requirements of practical reasonableness that hold because the human person must seek to realize and respect human goods not merely in himself and for his own sake but also in common, in community").

123. See BISHOPS' LETTER, *supra* note 24, at 23 (stating that "[b]asic justice demands the establishment of minimum levels of participation in the life of the human community for all persons."); COMMISSION REPORT, *supra* note 21, at 169 (noting that debtor must be permitted to retain basic means of survival) (emphasis omitted).

124. See T. SULLIVAN, AS WE FORGIVE, *supra* note 3, at 341 (asserting that "[t]he bankruptcy system rests on a free market philosophy that throws the social and economic risks of credit on creditors and debtors, rather than on society at large."). Cf. J. FINNIS, *NATURAL LAW*, *supra* note 23, at 175 (stating that distributive justice embodies concept of fairness such that decisions "often turn on whether some parties have *created* or at least *foreseen* and *accepted avoidable risks* while others have neither created them nor had opportunity of foreseeing or of avoiding or insuring against them"); Shuchman, *supra* note 29, at 439 (noting that bankruptcy law to some minor extent can be viewed as response to public problems in distribution and redistribution of wealth).

burdens of the past.¹²⁵ Furthermore, our present Code is a reflection of a public acceptance that at some point the debtor should not be forced into subjugation¹²⁶ so that he finds himself in the position of working solely for the benefit of his creditors.¹²⁷ Historically, there has been difficulty in maintaining a proper balance between the interests of debtors, creditors and society.¹²⁸ Even today efforts are being made to shift the scales back in

125. Other than a brief experiment with the 1867 Act, prior to 1898 there was a firm linkage between the two primary functions of the bankruptcy system. Specifically, debtor financial relief was dependent upon creditor approval. The rejection of creditor consent in liquidation bankruptcy was an acknowledgment by Congress of the separate and distinct underlying justification for that policy. *Compare* *Reed v. McIntyre*, 98 U.S. 507, 512 (1878) (stating that Court has "often declared that the *pro rata* distribution of the property of the bankrupt was the main purpose of the bankruptcy statute [1867 Act].") (citations omitted) (emphasis in original) *with* *Stellwagen v. Clum*, 245 U.S., 605, 617 (1918) (asserting that "[t]he federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a *main purpose of the act [Bankruptcy Act], intends to aid the unfortunate debtor* by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors.") (emphasis added). *See also* Riesenfeld, *The Evolution of Modern Bankruptcy Law*, 31 MINN. L. REV. 401, 406-08 (discussing progressive liberalization of American bankruptcy laws to point where laws no longer required creditor consent and minimum dividends). *Cf.* Levinthal, *Early History*, *supra* note 57, at 232 (asserting that world history of bankruptcy reflects "general evolution of legal process from the stage wer [sic] retaliation is the end in view to the stage where compensation is the chief desideratum").

126. *See* T. SULLIVAN, AS WE FORGIVE, *supra* note 3, at 334 (stating that "bankruptcy is one of the safety valves that sophisticated capitalism keeps in place to release the pressures of fear and greed that accompanies free market incentives."); Carlson, *Philosophy in Bankruptcy*, 85 MICH. L. REV. 1341, 1377 n.115 (1987) (positing that "the philosophical justification for discharge was to preserve individuals from permanent subjugation to their creditors.").

127. *But see* Gross, *Modern Day Peon*, *supra* note 20, at 166-67 (noting that courts have increasingly been using § 707(b) of the Bankruptcy Code). Section 707(b) authorizes a court upon its own motion or that of the trustee to dismiss a Chapter 7 proceeding for substantial abuse. *Id.* Gross posits that courts use this section to "suggest that if individual debtors want a discharge, they must utilize Chapter 13, the reorganization chapter in which the debtor works to obtain the income needed to repay creditors over time." *Id.* (footnotes omitted). Gross suggests that the Consumer Credit Amendments need to be interpreted narrowly to avoid forcing debtors to work to repay their debts. *Id.* at 205. This issue was the main bone of contention during the hearings on the Consumer Credit Amendments. The Purdue Study advocated increasing the costs of bankruptcy by limiting exemptions or by forcing debtors who could pay to take Chapter 13. *See* Sullivan, *supra* note 30, at 1070 (stating that "[t]he results of the [Purdue] Study lend support to legislative proposals to limit the access of debtors to bankruptcy discharge."). The Study was critical of the then 1978 Code that allegedly allowed discharge to debtors who were able to repay all or a substantial portion of their debts out of future income. PURDUE STUDY, VOL. I, *supra* note 15, at 30-80. For a critical review of the study's conclusion see Sullivan, Warren & Westbrook, *Limiting Access*, *supra* note 18, at 1103-38. Although this author does not see the Consumer Credit Amendments as a retreat from the values underlying the fresh start policy, any attempt to limit a debtor's option of Chapter 7 liquidation goes to the very heart of the moral justification of fresh start. This author, like Gross, feels that the ramifications of such a move need to be examined seriously before courts jettison any liferafts.

128. *See* C. WARREN, BANKRUPTCY HISTORY, *supra* note 57, at 144 (asserting that "a bankruptcy law is required in the public interest of the Nation at large and for its welfare, apart from the effect of the law upon the particular individuals on whom it is to operate").

favor of economic and political interests over those values inherent in a moral justification.¹²⁹ However, each of the earlier bankruptcy statutes has reflected an awareness of a moral dimension for debtor relief, albeit in some modest way.

The initial bankruptcy act¹³⁰ applied only to traders and was designed to alleviate the adverse economic conditions that followed excessive speculation in government script and stock.¹³¹ The statute provided for only involuntary proceedings¹³² and for the discharge of debts on a vote of two-thirds, in number and in value, of the creditors.¹³³ By making creditor consent a condition for discharge and providing for only involuntary petitions, the statute reflected only modest concern for the ethical values inherent in a moral justification of the bankruptcy process. In fact, the statute's real effect was not to achieve debtor relief, but to assist in creditor debt collection. The opposition to the law was immediate, and the act was repealed shortly after enactment.¹³⁴

The passage of numerous state laws abolishing imprisonment for debt further strengthened the opposition to additional federal legislation, which advocated that state insolvency laws could handle the "bankruptcy" matter.¹³⁵ However, the factionalism between debtors and creditors, merchants and farmers, and political parties, in conjunction with the financial panic of 1837, led to enactment of a federal statute in 1841. The 1841 Act¹³⁶ was the first of its kind to permit voluntary petitions.¹³⁷ However, the Act's effectiveness as a means of debtor relief was limited because discharge was conditioned upon a majority of the creditors in number and value of claims not filing written dissent.¹³⁸ Henry Clay, the great proponent of the 1841 Act, noted that the law was passed not only in response to the appalling economic conditions of the nation, but also "by all considerations of justice, humanity, and benevolence. . . ."¹³⁹ Furthermore, the Supreme Court

129. See, e.g., H.R. 4534, 101st Cong., 2d Sess. (1990) (introduced by Rep. Chapman (D-Tex) on April 18, 1990, which would amend § 523(a) of Code to make all debts nondischargeable in Chapter 7 also nondischargeable in Chapter 13).

130. Act of April 4, 1800, ch. 19, 2 Stat. 19.

131. C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 10-13.

132. 2 Stat. 21.

133. 2 Stat. 31. See generally C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 17 (positing that "we should rescue the honest and unfortunate insolvent from the oppression of a vindictive creditor") (quoting Representative Harrison Otis from Massachusetts).

134. 2 Stat. 248. The Southern states argued that the law was not workable in an agrarian economy and that state insolvency laws were far superior. Since the act was only involuntary by its terms, farmers suffered at the hands of their creditors. See F. NOEL, *supra* note 18, at 132.

135. See C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 52.

136. 1841 Act, *supra* note 49.

137. *Id.* at 441-42.

138. *Id.* at 443. However, discharge was mandated unless a majority in number and value of the creditors filed written dissent. *Id.*

139. C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 80 (Warren gives no reference for this statement attributed to Henry Clay).

acknowledged the ethical dimension of the 1841 Act by observing that one of the two purposes of the act was to discharge the "honest debtor".¹⁴⁰ However, the statute's use of federal exemptions without any homestead protection¹⁴¹ rekindled fear in the agricultural states regarding the potential loss of land by debtors.¹⁴² On the other hand, the statute's seemingly overall pro-debtor bent, especially in light of the availability of voluntary petitions, led to creditor dissatisfaction. Creditors asserted that the 1841 Act was not a bankruptcy statute but merely an insolvency statute, and, thus, its enactment was beyond the power of Congress.¹⁴³ It was repealed soon thereafter

140. *Buckingham v. McLean*, 54 U.S. (13 How.) 151, 166 (1851) (stating that "the two great objects of the [1841] law, . . . were to grant a discharge to honest debtors who should conform to its provisions, and to distribute their property ratably among all their creditors"). The term "honest" in conjunction with debtor, insolvent, or bankruptcy has consistently appeared in the cases and in Congressional considerations of the bankruptcy laws. *See, e.g.*, 1902 HOUSE REPORT, *supra* note 102, at 409 ("This amendment [referring to the amendment to make unliquidated debts arising from fraud nondischargeable] is in the interest of justice and honest dealing and honest conduct."). Justice Marshall in holding a state law which attempted to discharge pre-enactment contractual debt unconstitutionally noted "[t]o punish honest insolvency by imprisonment for life, . . . would be an excess of inhumanity. . . ." *Sturges v. Crowninshield*, 17 U.S.(4 Wheat.) 122, 200 (1819). The use of the term "honest" by courts and Congress is intentional and implies a moral dimension implicit in the general purposes of bankruptcy. *But see* Howard, *supra* note 20, at 1052 (asserting that "bankruptcy law is more accurately interpreted as a series of provisions reflecting ad hoc definitions of what is honest or worthy in particular situations").

141. 5 Stat. 443 (exempting from provisions of 1841 Act "necessary household and kitchen furniture, and such other articles and necessaries of such bankrupt . . . having reference in the amount to the family, condition, and circumstances . . . not to exceed . . . the sum of three hundred dollars; and, also, the wearing apparel of such bankrupt, and that of his wife and children; . . ."). The 1841 Act was generally considered more pro-debtor than its predecessor. *See, e.g.*, H.R. REP. NO. 5, 27th Cong., 1st Sess. 4 (1841) ("With us, in this country, it may be considered as wholly settled, by a wise and humane public sentiment and policy, that the law will pursue and will permit creditors to pursue an honest but unfortunate and hopelessly insolvent debtor no further, after what remains of his wrecked fortune has been equitably divided amongst those to whom he is indebted.").

142. *See* C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 32 (stating that during debates on earlier bankruptcy legislation prior to enactment of 1841 Act concern was voiced over lack of homestead exemptions in proposed federal legislation).

143. *See* F. NOEL, *supra* note 18, at 103-04. The problem was one of semantics. The historical distinction between insolvency and bankruptcy laws was unclear. The creditors, however, argued that since the statute permitted voluntary petition, it was an insolvency law. As such, the power to enact such a law was retained within the province of the states under the Constitution. The Supreme Court had earlier held that state insolvency laws could not discharge contractual obligations incurred prior to their enactment. *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 207-08 (1819). However, Chief Justice Marshall noted that the grant of power to the Congress was not an exclusive power, meaning that absent a federal enactment on the subject, a state law would be valid if it did not impair the right of contract. *Id.* at 193-96. In *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 369 (1827) the Supreme Court, over a strong dissent by Chief Justice Marshall, upheld the power of a state to legislate insolvency laws that could discharge debts incurred after their enactment, but could not discharge debts arising from obligations owed to nonresident creditors. These decisions reaffirmed the exclusive nature of the grant of power to Congress but did little to solve the basic definitional problem. Surprisingly, however, the issue disappeared upon the repeal of the 1841 Act, never to surface again. *See infra* notes 147-48 and accompanying text.

by the same Congress that enacted it.¹⁴⁴

Following the repeal of the 1841 Act, an air of prosperity arrived. This was followed by passage of state pro-debtor laws that prolonged the time for execution sales, required specific amounts to be bid at foreclosure sales, and increased state exemptions.¹⁴⁵ However, following the War between the States, increasing pressure from creditors and debtors led to the passage of a new act which contained both voluntary and involuntary provisions and provided for the incorporation of state exemptions.¹⁴⁶ Although the constitutionality of permitting voluntary petitions was vigorously contested during the congressional debates preceding the enactment of the 1841 Act, the Supreme Court never ruled on the validity of the 1841 Act.¹⁴⁷ However, by 1867 a bankruptcy law which permitted voluntary petitions was unquestioned.¹⁴⁸ The original version of the 1867 Act provided for discharge without creditor consent,¹⁴⁹ but this provision was quickly amended to require some form of creditor assent to discharge in voluntary cases.¹⁵⁰ The law was

144. Act of March 3, 1843, ch. 82, 5 Stat. 614. According to Noel, 33,739 debtors availed themselves of the law, of which more than 28,000 received discharge of nearly \$445,000,000 of obligations by surrendering less than \$45,000,000 worth of assets, which were distributed among 1,049,000 creditors. See F. NOEL, *supra* note 18, at 143-44.

145. C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 87-94.

146. 1867 Act, 14 Stat. 517, 521 (1867). The Act provided for voluntary petitions and provided for federal exemptions to include wearing apparel and other necessities as well as such other property as was made exempt by federal nonbankruptcy law and by the law of the bankrupt's domicile. *Id.* at 521-23.

147. See 1841 Act, 5 Stat. 440; *Nelson v. Carland*, 42 U.S. (1 How.) 265, 266 (1843) (dismissing for lack of jurisdiction case that questioned constitutionality of 1841 Act). Justice Catron filed a strong dissent asserting the constitutionality of the Act. *Id.* Furthermore, in his capacity as a circuit justice, Justice Catron reversed a district court's order which had dismissed a bankruptcy petition on grounds that the 1841 Act was unconstitutional. See *In re Klein*, 42 U.S. (1 How.) 277, 281 (1843) (finding the 1841 Act constitutional). Under our present constitutional system, states are unable to provide substantial debtor relief, because the existence of federal legislation preempts state discharge laws. See *International Shoe Co. v. Pinkus*, 278 U.S. 261, 268 (1929).

148. See *Michaels v. Post*, 88 U.S. (21 Wall.) 398, 427 (1874) (stating that power of Congress in enacting 1867 Act was exclusive); C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 87. Warren discusses that the focus of constitutional issues shifted from questions of state versus federal exclusivity, to questions of retroactive application and the constitutional mandate for uniformity. *Id.* See also *United States v. Security Indus. Bank*, 459 U.S. 70, 81 (1982) (stating that "[n]o bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of explicit command from Congress"); *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 188 (1902) (upholding 1898 Act attacked because state exemptions were not uniform by stating "uniformity is geographical and not personal, and we do not think that the provision of the act of 1898 as to exemptions is incompatible with the rule"); *In re Sullivan*, 680 F.2d 1131, 1137 (7th Cir.) (holding that opt out provision of 1978 Code did not violate constitutional mandate for uniformity), *cert. denied sub nom. Sullivan v. United States*, 459 U.S. 992 (1982).

149. 1867 Act, *supra* note 49.

150. By time of repeal consent of one-fourth in number and one-third in amount was required for discharge in voluntary cases where the debtor's assets did not equal thirty percent of liabilities. Act of June 22, 1874, ch. 390, § 9, 18 Stat. 178, 180. No payment requirements or creditor assent was required in involuntary cases. *Id.*

immediately subject to criticism on all sides¹⁵¹ and amendments began to proliferate.¹⁵² The act was repealed in 1878.¹⁵³

In discussing what he viewed to be the congressional intent of the 1867 Act, Chief Justice Waite observed that under certain conditions an honest debtor was to receive a discharge from those debts which he could not pay.¹⁵⁴ In another decision Chief Justice Waite further emphasized an ethical dimension that he viewed to be the essence of the bankruptcy process in the following language:

In no just sense do such governmental regulations deprive a person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not unnecessarily to injure another. . . . Every member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relations to others, he might have retained. Such concessions make up the consideration he gives for the obligation of the body politic to protect him in life, liberty, and property. Bankruptcy laws, whatever may be the form they assume, are of that character.¹⁵⁵

Justice Waite's analogy of a "social contract" in the bankruptcy context is consistent with the recognition of a mutual covenant relationship of ethical duties and obligations flowing between society and the financially down-trodden. As a member of society, one individual may have to part with certain legal rights in exchange for the betterment of the nation of which that individual is a part. On the other hand, to receive the benefit of the bankruptcy process, an individual has the duty and obligation to conduct his affairs in a fair manner in relation to the other individuals who comprise the nation.¹⁵⁶

Serious national economic reversals led to the enactment of the 1898 Act, which governed bankruptcy proceedings for eighty years.¹⁵⁷ The 1898 Act provided for voluntary and involuntary proceedings, discharge without

151. See J. BUSH, *supra* note 19, at 14-15 (noting major objections were to serious delays in administration of act and the excessive fees and expenses of administration); F. NOEL, *supra* note 18, at 154; C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 127-28.

152. See J. BUSH, *supra* note 19, at 13-14 (listing amendments to 1867 Act).

153. Act of June 7, 1878, ch. 169, 20 Stat. 99.

154. See *Wiswall v. Campbell*, 93 U.S. 347, 350 (1876). *Neal v. Clark*, 95 U.S. 704, 709 (1877). In the *Neal* case Justice Harlan noted that in interpreting the 1867 Act the Court must do so consistently with "the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency."

155. *Canada S. Ry. Co. v. Gebhard*, 109 U.S. 527, 536 (1883).

156. See, e.g., Rawls, *supra* note 90, at 11-17. Rawls' concept of justice as fairness has its roots in the social contract which is arrived at through rational choice. *Id.*

157. Bankruptcy Act, 30 Stat. 544. The Congressional debate centered on the plight of oppressed debtors caught in the latest economic panic. See F. NOEL, *supra* note 18, at 157-58.

creditor consent,¹⁵⁸ and the wholesale incorporation of state exemptions into federal law.¹⁵⁹ The Bankruptcy Act was a culmination of years of debate concerning the proper weight to assign the competing interests of debtors and creditors in the process, and represented the merger of the functions of creditor-oriented debt collection and debtor-oriented financial relief.¹⁶⁰ The Act also was an acknowledgment that the nation as a whole had a vested interest in the bankruptcy process.¹⁶¹ Additionally, the Act reflected an awareness by Congress that fresh start, through the protection of the honest, unfortunate debtor,¹⁶² was in fact a legitimate independent policy. The Act marked the end of the presumption of fault on the part of the debtor, and the beginning of the era of debtor freedom.¹⁶³ Finally, and most importantly, the Act established a national policy that the purported

158. Bankruptcy Act, 30 Stat. 550 (providing that discharge was available unless bankrupt failed to satisfy specific norms to assist in the discovery and recovery of assets). Under § 17 the discharge went to all provable debts except certain specified debts, including unpaid taxes and liabilities for fraud among others. *Id.* at 550-51. The Bankruptcy Act was almost immediately amended to narrow the scope of discharged debts. See 1902 HOUSE REPORT, *supra* note 102, at 409.

159. Bankruptcy Act, *supra* note 49.

160. See Noel, *supra* note 18, at 199 (noting that “[t]he race of diligence among creditors is at an end.”). See generally J. BUSH, *supra* note 19, at 15-19 (discussing congressional disputes among creditor and debtor interests over passage).

161. See H.R. REP. No. 65, 55th Cong., 2nd Sess. 32 (1897). The report states:

The friends of a bankruptcy law contend that when an honest man is hopelessly down financially, nothing is gained for the public by keeping him down, but, on the contrary, the public good will be promoted by having his assets distributed ratably as far as they will go among his creditors and letting him start anew. The recent financial crisis has crippled so many good, aggressive, useful citizens all over the country that present conditions appeal loudly for the passage of a bankruptcy law.

Id. See also F. NOEL, *supra* note 18, at 192 (asserting that “[f]or the common good, however, the State has authority to interpose and to set aside the rules of ‘natural justice.’ By virtue of this power bankruptcy laws have been established, which relieve the debtor who has complied with all the legal requirements and protect him against the courts and invocation of authority for the exaction of additional payments”).

162. See, e.g., *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) (holding that to enforce prebankruptcy assignment of future wages would be contrary to bankruptcy policy of relieving “‘the honest debtor from the weight of oppressive indebtedness and permit him to start afresh’”) (citation omitted). In *Local Loan* the court acknowledged that the purpose of the Bankruptcy Act was for “public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt”. *Id.* (emphasis in original) (citations omitted). An early commentary of the Act put it this way:

The law as it stands to-day, is emblematic of our modern civilized humanitarian development, and of the principle that ‘Justice oft must be tempered with mercy.’ Thus nations may prosper, remembering that for every loss there is a gain, that even utilitarianism has its charitable side, and that the stern decree of the ‘survival of the fittest,’ is tempered with the divine edict: ‘Let the strong bear with the weak.’

Hirschberg, *supra* note 27, at 239.

163. See, e.g., Ayer, *supra* note 67, at 369.

moral obligation to pay one's debts was not as significant a value as society's moral responsibility to assist the financially downtrodden debtor.¹⁶⁴

As America moved into and through the twentieth century, the increasing rise in the use of consumer credit led to a concomitant rise in bankruptcy filings by wage earners rather than small businessmen and merchants.¹⁶⁵ The increasing numbers of this new type of bankrupt resulted in the enactment of the Chandler Act¹⁶⁶ of 1938. This act supplemented the existing fresh start policy by permitting a wage earner to voluntarily retain all of his assets by agreeing to a plan to pay all or a part of his existing debt from future income. Upon completion of the plan, the bankrupt would receive a discharge of any unpaid balance of his debts.¹⁶⁷ Chapter XIII provided an alternative to the debtor who desired to satisfy his own ethical obligation to pay off all or a portion of his debts, but it did not reflect any change in the values inherent in the process.¹⁶⁸ However, because Chapter XIII offered little advantage over Chapter VII bankruptcy, the chapter's history was characterized by infrequent use.

164. See F. NOEL, *supra* note 18, at 200 (positing that "[t]he history of these laws is evidence of man's humanity to his fellow man."). See generally Shuchman, *supra* note 29, at 449-58 (discussing various ethical issues involved in debt repayment). Shuchman observes that "the fact that there is a legal remedy such as bankruptcy indicates that for our legislators it makes sense to ask whether the mere making of a promise is a good and sufficient reason for keeping it." *Id.* at 458. It is also interesting to note that both commentators of the bankruptcy clause of the Constitution through the enactment of the 1898 Act agree that the right of Congress to affect the rights of creditors and debtors for the general good is paramount and reflects the present purported consensus of what it means to be an honest debtor. F. NOEL, *supra* note 18, at 200; C. WARREN, *BANKRUPTCY HISTORY*, *supra* note 57, at 158-59.

165. See D. STANLEY & M. GIRTH, *supra* note 3, at 18-25 (noting that by 1940 almost seventy-five percent of all voluntary filings were by wage earners).

166. The Chandler Act, passed in 1938, first created Chapter XIII. Act of June 22, 1938, ch. 575, §§ 601-686, 52 Stat. 840 (codified at 11 U.S.C. §§ 1001-1086), *repealed by* Bankruptcy Act of 1978, Pub. L. No. 95-598, title IV, §§ 401(a), 402(a), 92 Stat. 2682. The Act was designed to offer a wage earner a remedy when he sought to repay rather than avoid his obligations. The idea behind the Act was to encourage debtors to pay their debts in full over time by offering certain inducements, such as not being adjudged a bankrupt and temporary suspension of state collection procedures. *Id.* See S. REP. No. 179, 86th Cong., 1st Sess. (1959), *reprinted in* 1959 U.S. CODE & CONG. ADM. NEWS 1446, 1447. See also *Perry v. Commerce Loan Co.*, 383 U.S. 392, 396-97, *reh'g denied*, 383 U.S. 934 (1966). Because of the problems which arose in Chapter XIII due to the statutory requirement of a majority vote (in number and amount) to approve the plan, 52 Stat. 934, 11 U.S.C. § 1052 (1938), Congress proposed a new Chapter 13 fashioned to overcome the rigidity of this act that denied the debtor full relief and limited the fresh start which was felt to be essential to modern bankruptcy law. HOUSE REPORT, *supra* note 52, at 119, *reprinted in* 1978 U.S. CODE CONG. & ADM. NEWS at 6080. For an interesting discussion of the background of Chapter 13 see *In re Scher*, 12 Bankr. 258, 261-66 (Bankr. S.D.N.Y. 1981).

167. Chandler Act, 52 Stat. 935-36, 11 U.S.C. § 1060 (1938). The scope of discharge upon successful completion of the plan was essentially identical to Chapter VII discharge.

168. See, e.g., *Lines v. Frederick*, 400 U.S. 18, 20 (1970) (stating that "[t]he wage-earning bankrupt who must take a vacation without pay or forgo a vacation altogether cannot be said to have achieved the 'new opportunity in life and [the] clear field for future effort, unhampered by the pressure and discouragement of preexisting debt,' . . . which it was the purpose of the statute to provide.") (citation omitted).

As a result of many perceived problems in the bankruptcy process, Congress in 1970 authorized a Commission to determine the necessity of reforming the Bankruptcy Act.¹⁶⁹ Following the report of the Commission, extensive Congressional hearings took place, resulting in the compromise Bankruptcy Code of 1978. The Code was the first bankruptcy law passed without the direct intervention of a financial disaster. There is a problem with determining the underlying *goals* sought to be achieved by Congress in the enactment of the Code's fresh start policy because of the lack of a clear legislative history.¹⁷⁰ On the other hand, the *values* underlying the enacted fresh start policy are obvious. The stronger debtor orientation in the discharge provisions, as compared with the former law,¹⁷¹ represents continued congressional support for the humanitarian values inherent in the bankruptcy process.¹⁷²

The consumer credit industry took immediate steps to criticize the broad, expansive fresh start granted by the Code.¹⁷³ Although the consumer credit lobby sought to convince Congress to impose harsh limitations on the availability of Chapter 7 and more stringent payments plans under Chapter 13, the Consumer Credit Amendments that resulted from their efforts were ineffective.¹⁷⁴ Several academicians have expressed the view that these changes

169. S.J. RES. 88, 84 Stat. 468, Pub. L. 91-354 (1970). The Joint Resolution outlines the conditions which prompted the creation of the Commission as follows: "(1) the increase in the number of bankruptcies by more than 1000 percent in the preceding twenty years; (2) the widespread feeling among referees in bankruptcy that problems of administration required substantial improvement in the Act; (3) the impact on the operation of the Act of the vast expansion of credit; and (4) the limited experience and understanding in the Federal Government and the nation's commercial community in assessing the operation of the Bankruptcy Act." COMMISSION REPORT, *supra* note 21, at 1. The resolution sought recommendations for changes in the Act which would "reflect and adequately meet the demands of present technical, financial, and commercial activities." *Id.* at 1-2.

170. See Klee, *Legislative History of the New Bankruptcy Code*, 54 AM. BANKR. L.J. 275, 276 (1980). The key House and Senate reports to the Code antedate the actual passage of the Code and amendments were made to the Code up until its date of passage. HOUSE REPORT, *supra* note 52, at 1-549, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 5963-6435; S. REP. No. 989, 95th Cong., 2d Sess. 1-176 (1977), reprinted in U.S. CODE & CONG. ADM. NEWS 5787-5962 [hereinafter SENATE REPORT].

171. See Cohen & Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N.C.L. REV. 681, 721 (1980); Hallinan, *supra* note 3, at 86.

172. See Hallinan, *supra* note 3, at 86 (noting that Code reflects triumph of those who felt goal of law ought to be to alleviate effects of financial failure).

173. See PURDUE STUDY VOL. II, *supra* note 4, at 139 (stating that "[b]y providing a legal method to uncouple the legally binding credit contract between the lender and borrower, the current bankruptcy law could be expected to increase the risk and therefore the cost of all unsecured credit."); Gross, *Preserving Fresh Start*, *supra* note 20, at 76-80; Sullivan, Warren & Westbrook, *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 WISC. L. REV. 1087, 1093.

174. There is little legislative history to reflect congressional intention for the Consumer Credit Amendments. There was no official report from either the House or the Senate. See 130 CONG. REC. H1809 (daily ed. March 21, 1984) (Representative Hyde stated that Congress avoided "providing a sound authentic basis for legislative history, that unique resource most

mark a retreat in the fresh start policy.¹⁷⁵ However, these amendments should be viewed as modest limitations at best in the scope of the fresh start policy. The overall moral justification remains, and the values underlying that justification still form the foundation of debtor financial relief. The release from the legal obligation to pay one's debts always must be tempered with society's concerns of social justice for all its members. These amendments do not mark a retreat in the historical trend that has seen debtor relief move from a process of achieving greater payments to creditors¹⁷⁶ to a concern for the wellbeing of the financially downtrodden.¹⁷⁷ The nature

relied upon by the courts to plumb the legislative intent of this learned body, . . ."). Although there was a great deal of information elicited at hearings and various statements made on the floors of each house on the date of passage on June 29, 1984, there is not a distilled legislative intent. There are of course various "unofficial" legislative histories. See, e.g., *In re Keniston*, 60 Bankr. 742, 744-45 (Bankr. D.N.H. 1986); *In re Grant*, 51 Bankr. 385, 388-93 (Bankr. N.D. Ohio 1985); *In re White*, 49 Bankr. 869, 872 (Bankr. W.D.N.C. 1985). See also Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM. & MARY L. REV. 91 (1985). In the area of consumer bankruptcy there were three modest changes that impacted debtors. Bankruptcy Code § 707(b) (permitting court on own motion and that of trustee to dismiss a Chapter 7 case for substantial abuse); Bankruptcy Code § 1325(b) (permitting an objecting unsecured creditor to a Chapter 13 plan to force the use of all the debtors disposable income to fund a plan); Bankruptcy Code § 1329(a) (permitting a party in interest to request a modification of the Chapter 13 plan after confirmation). The statute also enlarged the scope and effect of the discharge by expanding the prohibition against governmental discrimination to include private employers as well. Bankruptcy Code § 525(b).

175. See Gross, *Fresh Start*, *supra* note 20, at 82 (stating that "Congress's capitulation to the creditors position is no surprise."); Hallinan *supra* note 3, at 96 (positing that "[i]n short, Congress having briefly experimented with a relatively unequivocal vision of the 'fresh start' policy, appears to have become troubled by what it wrought and to have retreated to the familiar comforts of statutory obscurity."). Cf. *In re Walton*, 866 F.2d 981, 985 (8th Cir. 1989) (citing with approval Ninth Circuit's decision in *In re Kelly*, 841 F.2d 908 (1988), which held that debtor's ability to pay his debts when due as determined by his ability to fund Chapter 13 plan is primary factor courts should consider in determining cases of substantial abuse under Section 707(b)).

Decisions like *Walton* clearly lend support to fears that the Consumer Credit Amendments mark a retreat from the high water mark of fresh start policy. The problem, however, is that commentators and courts are refusing to focus on the ethical considerations implicit in the law. By doing so, it would become apparent that substantial abuse in a Chapter 7 case must refer to prepetition conduct of the debtor that fails to meet standards of commutative justice. An ethical approach to these issues can avoid the "alleged retreat."

176. Discharge began in English law as an encouragement to debtors to obey the law and to cooperate with the bankruptcy process which had been started by the creditors. See 4 Anne, ch. 17 (1705); J. MACLACHLAN, *HANDBOOK OF THE LAW OF BANKRUPTCY* 88 (1956).

177. Fresh start policy and the goals sought to be achieved through it are often muddled by the use of the words "worthy" and "honest." See Howard, *supra* note 20, at 1050-59 (noting confusion regarding fresh start policy). Trying to correlate reasons for or against granting a discharge or for resolving a dischargeability issue in these terms often leads to hapless confusion. However, to disregard the underlying values intrinsic in these terms and to begin "afresh" with economic models or approaches of incentives or disincentives misses the mark. Historically, in the area of debtor financial relief there has been one and only one issue that has constantly been given significant approval by courts and Congress: the need to assist the financially downtrodden. Even when the moral justification has directly conflicted with economic or political matters, Congress has always given these ethical concerns the greatest weight.

of that response may change as a result of economic or political pressures,¹⁷⁸ but the fundamental principle now is entrenched too firmly to be questioned. In fact, despite heavy lobbying, Congress clearly has rejected the credit industry's "pay till it hurts" position.¹⁷⁹ Thus, although a more demanding payment requirement was imposed in Chapter 13 cases, the broad discharge remained unaffected in Chapter 13,¹⁸⁰ even though efforts were made to severely restrict it.¹⁸¹

Our present system of debtor financial relief has rejected the significant use of economic incentives or disincentives to motivate debtor conduct.¹⁸² The process represents an awareness that debtors are real people and cannot

178. See Shuchman, *supra* note 29, at 444-45.

179. See T. SULLIVAN, *AS WE FORGIVE*, *supra* note 3, at 335. In perhaps the most insightful statement in *AS WE FORGIVE* the authors observe: "Yet bankruptcy is not itself the cause of anything—only the result." *Id.* at 328.

180. See 11 U.S.C. § 1328(a); S. REP. No. 65, 98th Cong., 1st Sess. 20-22 (1983) (discussing problems generated by small payout plans in Chapter 13 and recommending amendment to Chapter 13 requiring all income not necessary for support of debtor and his family be dedicated to plan). The Report accompanied S. 445, 98th Cong., 1st Sess. (1983), a bill passed by the Senate in 1983. The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, incorporated this proposal of the Senate with modification.

181. See S. REP. No. 65, 98th Cong., 1st Sess. at 17 (1983) (noting that debtors under Chapter 13 plans were paying extremely small amounts on debts which would have been non-dischargeable in Chapter 7, and recommending that § 1328(a)(2) be amended to prohibit discharge of unpaid § 523(a) debts after completion of Chapter 13 plan). In enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984 the changes suggested in SENATE REPORT No. 65 were rejected. The failure of Congress to make statutory changes can give guidance in determining Congressional intent. See *Erlenbaugh v. United States*, 409 U.S. 239, 247-48 (1972); *The Effect of an Unsuccessful Attempt to Amend a Statute: A Correspondence Between Charles H. Willard and John W. MacDonald*, 44 Cornell L.Q. 336 (1959).

182. It has long been the position of certain law and economic scholars that by manipulating the alleged benefits and costs of the bankruptcy law, one could predictably affect debtor behavior. See Meckling, *supra* note 42, at 27 (stating that "[c]hanges in bankruptcy law which lower the costs or raise the benefits to debtors of one of those three options [Chapter VII, Chapter XIII, or informal settlements] will without question increase both the number of debtors who elect that option and the total number of debtors who elect one of the three in preference to repayment."). Cf. Posner, *The Economic Approach to Law*, 53 TEX. L. REV. 757, 763 (1975) (arguing that "the legal system is treated as a given and the question studied is how individuals or firms involved in the system react to the incentives that it imparts"). Because arguably under neoclassical economic theory debtors are rational maximizers, these debtors' behavior could be predicted and controlled or strongly influenced by economic incentives or disincentives. See Vukowich, *Reforming the Bankruptcy Reform Act of 1978: An Alternative Approach*, 71 GEO. L.J. 1129, 1153 (1983).

The use of microeconomic models based on simplistic or unrealistic assumptions is uniformly used in other areas of economic analysis as an intuitive and nonmathematical way to analyze legal issues. However, the Consumer Bankruptcy Project's conclusions have cast serious doubt upon the ability of simplistic economic models (such as those used in the Purdue Study) to be predictive of debtor behavior to economic incentives. Sullivan, Warren and Westbrook, *Real People*, *supra* note 15, at 705-06. When viewed in a macroeconomic perspective, however, even the conservative law and economic scholar should be willing to acknowledge that there are certain economic and noneconomic gains to society as a whole by any system of debtor relief.

be controlled or manipulated through economic models or unrealistic assumptions concerning their behavior.¹⁸³ Historically, fresh start policy has acknowledged both the humanitarian response of a nation to the impoverished debtor and the realization that there is a covenant between a debtor and society that requires a certain level of fair dealing on the part of the debtor. The historical treatment of debtors in the United States also reflects a rich heritage of growth in the area of social justice. Thus, the underlying goal of the consumer bankruptcy process has evolved from retaliation, to compensation, and now to compassion and concern for those less fortunate in our society. Through this evolution the fundamental values of dignity, humanitarianism, and fairness have become more firmly entrenched.¹⁸⁴

This brief historical journey has established that the moral dimension is now and always has been a part of the debtor financial relief process. Intertwined with economic and political issues, concepts of dignity and justice have been at the very root of the bankruptcy process from its inception. The continued vitality of the process demands that courts remain attached firmly to this moral foundation. By approaching issues of debtor relief in this manner, perhaps courts can begin to regenerate public values of morality.¹⁸⁵ This article now turns to an application of the moral justification in two current areas of concern for the consumer debtor.

THE LIEN AVOIDANCE PROBLEM

Historically, discharge in and of itself has not been considered sufficient to give the debtor a fresh start. Accordingly, our bankruptcy laws have provided for the retention of certain assets by the debtor to give him a minimal new beginning.¹⁸⁶ Traditionally, the bankruptcy laws have relied primarily upon nonbankruptcy state exemption laws to place certain property beyond the reach of creditors.¹⁸⁷ However, the present Code provides a

183. See Sullivan, Warren & Westbrook, *Real People*, *supra* note 15, at 706 (stating that "models without supporting data should be treated like Trojan horses").

184. Although referring to the law in general, Lon Fuller's following comment equally is applicable to the bankruptcy process: "In one aspect our whole legal system represents a complex of rules designed to rescue man from the blind play of chance and to put him safely on the road to purposeful and creative activity." L. FULLER, *supra* note 22, at 9.

185. See Fiss, *supra* note 41, at 15 (asserting that "[w]e need public morality to have law, true, but even more, we need law to have a public morality.").

186. The development of exemptions in Anglo-Saxon jurisprudence can be traced to the period where inability to pay one's debts was no longer considered a crime and the recognition of the need for minimal property free from creditors' claims. See F. NOEL, *supra* note 18, at 28-29.

187. See *supra* notes 130-68 and accompanying text. The Supreme Court has held that the constitutional provision did not prevent incorporation of state law into federal bankruptcy law despite the fact that such would lead to different results depending on the state in which the debtor resided. *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 188 (1902). Bankruptcy law is uniform "when the trustee takes in each State whatever would have been available to the creditors if the bankruptcy law had not been passed. The general operation of the law is uniform although it may result in certain particulars differently in different States." *Id.* at 190.

debtor with the option of declaring exemptions under the laws of the state of his residence¹⁸⁸ or under a newly created federal list of exemptions.¹⁸⁹ The Code also provides that the states have the power to eliminate this debtor option by opting out of the federal scheme of exemptions.¹⁹⁰ As of this writing thirty-five states¹⁹¹ have elected to opt out, leaving their residents with only state exemptions.¹⁹²

188. The Report of the Commission was highly critical of the reference to nonbankruptcy law to determine exemptions under bankruptcy legislation. COMMISSION REPORT, *supra* note 21, at 171 (the Report suggested a federal exemption system to avoid "the unfairness of existing state exemptions laws, most of which are archaic, some of which are unduly generous, and some of which are exceedingly niggardly, particularly as to urban residence") (citation omitted).

189. 11 U.S.C. § 522(b). Section 522(b) provides in part:

Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. . . . If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or in the alternative, (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located.

Id. Section 522(d) lists the federal exemptions which specifies eleven different categories of property which Congress felt necessary for minimum existence.

190. Bankruptcy Code § 522(b)(1). The original House bill, H.R. 8200, 95th Cong., 1st Sess. (1977), did not contain this opt-out provision. The Senate proposed the adoption of exemption laws of the debtor's resident state noting that the liberal federal exemptions proposed by the House would be contrary to the policy of the bankruptcy laws by giving the debtor "instant affluence," not a fresh start. See SENATE REPORT, *supra* note 170, at 6, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 5792. The choice between state or federal exemptions and the opt-out provision was the result of a compromise between these two viewpoints. The constitutionality of the opt-out provision has been upheld. See *In re Sullivan*, 680 F.2d 1131, 1137-38 (7th Cir.), cert. denied, 459 U.S. 992 (1982) (holding that Bankruptcy Code's opt-out provision did not violate constitutional command that bankruptcy statute be uniform).

191. See 1 NORTON, BANKRUPTCY LAW & PRACTICE § 26, exemption app. 1-201 (1987 & Supp. 1989, 1990) (listing states that have opted out).

192. The compromise resulting in the present § 522(b) has been widely criticized. See, e.g., *In re Thompson*, 867 F.2d 416, 421 (7th Cir. 1989) (stating that "the entire scheme of optional state exemptions [a scheme that includes as we saw a provision authorizing the state to opt out] that underlies the difficulties of the present case is such a mess as to call into question the skill of the Code's draftsmen with regard to questions of exemption generally"); Randleman, *Liquidation Bankruptcy Under the '78 Code*, 21 WM. & MARY L. REV. 575, 650-52 (1980); Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 771, 803-04 (1980). See also Haines, *Section 522's Opt-Out Clause: Debtor's Bankruptcy Exemptions in a Sorry State*, 1983 ARIZ. ST. L.J. 1. Haines observes that Congress failed to recognize the problem it created by "on the one hand, articulating a policy protecting a debtor's fresh start by enabling him to avoid nonpossessory, nonpurchase-money securities interest in exempt property while, on the other hand, declaring deference to state exemption statutes which could preclude operation of lien avoidance powers, by eliminating exemptions in the presence of liens." *Id.* at 30.

To protect a "debtor's exemptions, his discharge and, thus, his fresh start,"¹⁹³ Congress enacted section 522(f) of the Bankruptcy Code.¹⁹⁴ This section authorizes debtors to avoid certain nonpurchase-money liens on exempt property to the extent that such liens impair exemptions. This statute was a direct congressional response to two separate but pervasive problems that hindered the fresh start policy. The first problem was the blanket security interest taken in household goods.¹⁹⁵ Congress responded by per-

193. HOUSE REPORT, *supra* note 52, at 362, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 6318; SENATE REPORT, *supra* note 170, at 76, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 5862. Both of the reports noted that a debtor may avoid such liens to the extent that the "property could have been exempted in the absence of the lien." *Id.* (emphasis added). Both houses of Congress were also concerned with state laws that permitted waivers of exemption rights. *Id.* To preserve this avoidance power, Congress greatly restricted the creditors' right to effectively use waivers in a bankruptcy proceeding. Section 522(e) makes unenforceable waivers executed in favor of unsecured creditors on property the debtor chooses to exempt and makes unenforceable waivers that attempt to restrict the debtors power to avoid liens under § 522(f). The waiver of exemptions can have both a direct and an indirect impact on the debtor. *See, e.g.,* Cross, *The Application of Section 522(f) of the Bankruptcy Code in Cases Involving Multiple Liens*, 6 BANKR. DEV. J. 309, 312-13 (1989). An example of the direct waiver would be a debtor's execution of a document that explicitly waives his right to an exemption. However, just as devastating is the indirect waiver of an exemption by giving a valid security interest in property that otherwise would be exempt. Congress dealt with this indirect waiver by the enactment of § 522(f).

194. 11 U.S.C. § 522(f) provides:

(f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is

(1) a judicial lien; or

(2) a nonpossessory, nonpurchase-money security interest in any—

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

HOUSE REPORT, *supra* note 52, at 126-27, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 6087-88.

195. The House Report contained the only significant legislative history on the section. The Report stated that creditors often take a blanket security interest as a form of leverage to force the debtor to pay the debt by threatening total repossession should the debtor fail to pay. The Report continued by stating that in the event of sale by the creditor the receipts would be minuscule compared to the replacement cost to the debtor. *Id.* The Commission had recommended that "nonpurchase money security interests should not be enforceable as to items of property essential to a debtor's well being, such as wearing apparel, which are of little or no value to a creditor, other than as a means of coercing payment." COMMISSION REPORT, *supra* note 21, at 169. The final provision as enacted allowed avoidance of nonpossessory, nonpurchase money security interests on a wider range of "necessities." *See generally* Nowka, *Debtor's Right to Avoid Nonpossessory, Nonpurchase-Money Security Interests: Effect of State Lien Conservation Statutes*, 18 U.C.C. L.J. 127, 149-56 (1985). The Federal Trade Commission had identified the problem of nonpurchase-money nonpossessory blanket liens as an abuse with no justification. *See* HOUSE REPORT, *supra* note 52, at 171-72, reprinted in 1978

mitting debtors to avoid such liens in whole or in part,¹⁹⁶ which preserved for debtors a minimum amount of exempt property to begin their fresh start. The second problem was that creditors brought legal proceedings against a debtor shortly before bankruptcy and obtained judicial liens on the debtor's property.¹⁹⁷ Congress has sought to limit the power of creditors, whatever the underlying nature of their claim, to obtain these liens. Thus, the lien avoidance power under section 522(f) was extended to judicial liens. Since the ability to avoid judicial liens to preserve exemptions was a judicially recognized doctrine that predated the Code,¹⁹⁸ the enactment of section 522(f)(1) was generally considered a codification of the earlier doctrine.¹⁹⁹

U.S. CODE CONG. & ADM. NEWS at 6132-33 (statement of David H. Williams, attorney, Federal Trade Commission) (noting that use of such devices provide effective lever for securing refinancing and securing anticipatory reaffirmation of debt otherwise dischargeable). The Federal Trade Commission subsequently enacted regulations that attack the practice in a nonbankruptcy situation as to creditors holding such liens. See FTC Trade Regulation Rule on Credit Practices, 16 C.F.R. §§ 444.1-5 (1985).

196. The avoidance power goes only to that portion of a lien that impairs an exemption. Thus, to the extent that a lien exceeds the allowed exemption, that lien will continue to exist in part.

197. See HOUSE REPORT, *supra* note 52, at 126-27, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 6087-88 (stating that "[i]f the creditor beats the debtor into court, the debtor is nevertheless entitled to his exemptions."). See generally Bowmar, *Avoidance of Judicial Liens That Impair Exemptions in Bankruptcy: The Workings of 11 U.S.C. § 522(f)(1)*, 63 AM. BANKR. L.J. 375 (1989).

198. See *Chicago, Burlington & Quincy R.R. Co. v. Hall*, 229 U.S. 511 (1913). The Bankruptcy Act automatically invalidated all liens obtained by judicial process against an insolvent within four months prior to the filing of the bankruptcy proceeding. However, because exempt property was not property of the estate under the Act, it was not clear prior to *Hall* whether the debtor could avail himself of this avoidance power. The Supreme Court in *Hall* interpreted the Act to permit the bankrupt to invalidate liens on property set aside by him as exempt. *Id.* at 514-15. The Court noted that such an interpretation would discharge "him from his liabilities and enabl[e] him to start afresh with the property set apart to him as exempt." *Id.* at 515. Following *Hall* there was a divergence of views concerning what the result would be when a preexisting judicial lien attached to property which subsequently became exempt or was acquired after the lien attached. The majority of the cases held that a bankrupt could not benefit through the avoidance procedure. See, e.g., *Hemsell v. Rabb*, 29 F.2d 914, 915 (5th Cir. 1929) (holding that bankrupt not entitled to use avoidance power because under Texas law he only acquired "the equity in the land over and above the pre-existing lien"); *In re Porter*, 3 F. Supp. 582 (S.D. Fla. 1933).

199. See *In re Ashe*, 712 F.2d 864, 867 (3d Cir. 1983) (stating that "[w]ith respect to avoidance of judicial liens, Congress was in 1978 doing nothing more than it had done eighty years earlier."), *cert. denied*, 465 U.S. 1024 (1984). In *Ashe* the court held that the statutory power to avoid judicial liens could be retroactively applied in spite of the rule in *Holt v. Henley*, 232 U.S. 637, 639-40 (1914) (stating that in absence of clear expression of congressional intent, statute purporting to divest property interest would be applied only prospectively). The court reasoned that Congress was well aware of the *Hall* decision, and understood that § 522(f)(1) was intended to preserve that rule. *Ashe*, 712 F.2d at 867. Thus, to apply the statute to judicial liens created prior to its enactment did not violate a property owners constitutional rights because the same result followed under the Bankruptcy Act. *Id.* at 868. Given this generally recognized fact, it is not surprising that the legislative history for § 522(f)(1) is noticeably less informative.

Clearly, section 522(f) is an integral part of the humanitarian response of Congress in implementing financial relief for individual debtors. Upon receiving his discharge, a debtor has his future earning power in hand. Also, he may continue forward with minimal goods in the form of exempt property, which remains free from most creditors,²⁰⁰ except to the extent that liens on such property cannot be avoided.²⁰¹ However, the effectiveness of section 522(f) seriously has been impeded in those states which have lien conservation or preservation statutes.²⁰² These laws define exempt property for purposes of state exemption laws in a way that prevents the application of the lien avoidance statute.²⁰³ The failure of courts to acknowledge the

200. See Bankruptcy Code § 522(c)(1) (stating that exempt property is still subject to debts arising from taxes and family support obligations).

201. See Bankruptcy Code § 522(c)(2) (providing debtor's exempt property is still liable after case for claims of creditors holding unavoidable liens in such property). If a secured creditor has an interest in the property declared exempt by the debtor, the interests of that creditor will take priority over that of the debtor unless and to the extent avoided. An interesting anomaly is created in that although the obligation to repay on the part of a debtor is extinguished, the lien and obligation of the property itself to an unavowed creditor continues. See *Long v. Bullard*, 117 U.S. 617 (1886). The legislative history of § 522 clearly indicates that the rule of *Long* is accepted and that the bankruptcy discharge "does not prevent enforcement of valid liens on nonexempt property as well as on exempt property." See HOUSE REPORT, *supra* note 52, at 361, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 6317; SENATE REPORT, *supra* note 170, at 76, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 5862. Thus, if an unavowed lien survives bankruptcy, only the personal liability of the debtor is eliminated. Cf. *In re Lindsey*, 823 F.2d 189 (7th Cir. 1987) (discussing lien avoidance under § 506(d)). The alienability of exempt property is not contrary to the values inherent in the moral justification for debtor financial relief. To acquire what becomes exempt property it often is necessary to incur debt. Thus, the very existence of exempt property can be dependent upon the actions of certain creditors. To permit the avoidance of such liens would be to violate principles of commutative justice. The covenant relationship between society and the debtor which gratuitously grants the humanitarian gift of exempt property imposes upon the debtor the reciprocal obligation and responsibility to return the purchase price. Thus, to keep property, in all fairness one must pay for it. Although the avoidance of all nonpossessory, nonpurchase-money liens could be justified on grounds of fairness (in that those obligations are not related to the creation of the exempt property), the present system of limited avoidance found in § 522(f) is morally justified. It is the lack of direct reciprocal benefits and burdens that supports the inalienability of the right of discharge under the moral approach advocated in this article.

202. See *Nowka*, *supra* note 195, at 129. *Nowka* identifies lien preservation or conservation statutes as those laws which conserve liens on exempt property "by either preventing the application of exemptions from impairing security interests, prohibiting the application of exemptions to property in which the debtor has voluntarily granted a security interests, or defining the amount of exemption or the debtors interest in the exemption to be the value of the asset exclusive of liens or to be the debtor's equity." *Id.* The problem generated by these statutes is exacerbated because some courts have adopted the position that § 522(f) does not come into play unless there is an actual right to an exemption under state law, as opposed to determining whether there would be a right to an exemption under state law in the absence of a lien. See, e.g., *In re McManus*, 681 F.2d 353, 357 (5th Cir. 1982) (holding that under Louisiana law, because household goods and furnishings subject to chattel mortgages are not exempt, Louisiana debtor may not avail himself of § 522(f)).

203. See, e.g., TEX. PROP. CODE ANN. § 42.001(a) (Vernon 1984) (providing that "[e]ligible

humanitarian and human dignity values inherent in exemptions²⁰⁴ has resulted in the emasculatation of the fresh start policy in these states for debtors who select state exemptions.²⁰⁵ Florida serves as a prime example.

In *In re Owen*, creditor Helen Owen obtained a final judgment against the debtor in 1975, which she promptly filed in the real property records

personal property that is owned by a family and that has an aggregate fair market value of not more than \$30,000 is exempt from attachment, execution, and seizure for the satisfaction of debts, except for encumbrances properly fixed on the property.”); *In re Allen*, 725 F.2d 290, 293 (5th Cir. 1984) (holding that under Texas law property subject to security interest is not exempt, thus § 522(f) can be of no avail in avoiding liens on such property). *But see In re Thompson*, 59 Bankr. 690, 696 (Bankr. W.D. Tex. 1986) (stating that *Allen* case is “simply wrong”).

204. A part of this problem can also be traced to commentators who have also failed to tie exemptions together with discharge in an articulation of any justification for fresh start policy. Professor Jackson, for example, views § 522(f) as a proper subject of uniform national legislation justified “on the ground that the pervasiveness of impulsiveness, incomplete heuristics, and externalities.” T. JACKSON, LOGIC AND LIMITS, *supra* note 37, at 265. *But see* HOUSE REPORT, *supra* note 52, at 126, reprinted in 1978 U.S. CODE CONG. & ADM. NEWS at 6087 (stating that “H.R. 8200 adopts the position that there is a Federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start. Recognizing, however, the circumstances do vary in different parts of the country, the bill permits the States to set exemption levels appropriate to the locale, and allows debtors to choose between the State exemptions and the Federal exemptions provided in the bill. Thus, the bill continues to recognize the States’ interest in regulating credit within the States, but enunciates a bankruptcy policy favoring a fresh start.”) (emphasis added) (citation omitted); *In re McManus*, 681 F.2d at 358 (Dyer, J., dissenting) (asserting that “Congress recognized that exemptions, whether state or federal in origin, are an essential feature of the system of financial rehabilitation afforded the hapless debtor in bankruptcy proceedings. Congress reasoned that since exemptions are so essential to this goal of rehabilitation they should be made available to debtors regardless of whether or not state law would permit their waiver or surrender.”).

205. Although the arguments presented in the various cases differ depending on the particular state statute involved, the basic position is similar. Because state law limits or eliminates exemptions in property subject to security interest, or defines exempt property as the debtor’s equity only, § 522(f) is not applicable. If the property or the debtor’s interest in the property is not exempt, then the lien does not impair an exemption. Thus, there is no need to avoid a lien. On the other hand, there is no logical interpretation of the statutory language of § 522(f) that would lend support to an argument that the lien avoidance provision applies only when a debtor takes the federal exemptions. *See, e.g., In re Maddox*, 713 F.2d 1526, 1529-30 (11th Cir. 1983) (acknowledging universality of lien avoidance and applying it to situation where debtor had no equity in property under state law). In fact, even in those cases where lien avoidance has been denied because of state lien conservation statutes, the courts have given “lip service” to § 522(f). *See, e.g., In re Allen*, 725 F.2d at 293 (stating that “[i]f one elects to use the Texas exemption statute, any property exempt under the statute is subject to the section [522](f) lien avoidance.”). In states where the federal exemptions are available, a debtor is allowed to avoid liens on property permitted under the federal laundry list despite the existence of no equity. *See, e.g., In re Dixon* 885 F.2d 327, 330 (6th Cir. 1989) (noting in dicta that federal exemptions permit avoidance even if debtor has no equity); *In re Brown*, 734 F.2d 119, 125 (2d Cir. 1984) (holding that debtor who had selected federal exemptions could avoid lien even in cases where debtor had no equity interest in property). In *Brown* the court reasoned that the legislative history provided that a debtor could avoid a lien “to the extent that the property could have been exempted in the absence of the lien.” *Id.* (citation omitted).

of Sarasota County, Florida.²⁰⁶ Under Florida law this judgment lien would have attached to all the real property of the debtor in the county except the debtor's homestead.²⁰⁷ As luck would have it, however, the debtor had no homestead. Over eight years later in 1984, the debtor acquired a condominium in Sarasota County, but because the debtor was a single person, the debtor was not entitled under Florida law to a homestead exemption at the time of acquisition.²⁰⁸ Thus, the judgement lien attached to the property. In 1985, the Florida Constitution was amended to permit a single person to acquire a homestead.²⁰⁹ In January of 1986, the debtor filed a Chapter 7 bankruptcy proceeding claiming the condominium as exempt.²¹⁰ The bankruptcy court in an unreported decision denied the debtor's motion to avoid the lien.²¹¹ The case was appealed to the district court, which affirmed the decision of the bankruptcy court.²¹² The district court held that even though Florida had opted out of the federal exemption scheme, section 522(f) could still apply.²¹³ However, because the debtor's interest was subject to the preexisting lien at the time of acquisition, the court held that the lien was not avoidable.²¹⁴

The court of appeals affirmed the lower court's decision. The court rejected the debtor's argument that section 522(f)(1) allowed him to avoid the lien because at the time of the filing of the bankruptcy petition he qualified for the Florida homestead exemption.²¹⁵ The opinion briefly addressed the issues involved without any serious consideration of the underlying justifications for lien avoidance. The court merely noted that under Florida law preexisting judgment liens attach to subsequently acquired homestead rights. Simply stated, under Florida law the debtor's homestead

206. *In re Owen*, 86 Bankr. 691, 693 (D.C.M.D. Fla. 1988), *aff'd*, 877 F.2d 44 (11th Cir. 1989), *cert. granted sub nom. Owen v. Owen*, 110 S. Ct. 2166 (1990).

207. FLA. CONST. art. X, § 4 (1968, repealed 1985). *See also Bessemer v. Gersten*, 381 So.2d 1344, 1348 (Fla. 1980) (holding that under Florida Constitution where property acquired homestead status after lien came into existence, lien would be valid).

208. *In re Owen*, 86 Bankr. at 693. At the time of acquisition of the condominium, the Florida Constitution did not permit a single person who was not the head of a family to acquire a homestead. FLA. CONST. art. X, § 4 (1968, repealed 1985).

209. FLA. CONST. art. X, § 4. This amendment was effective January 8, 1985, and permitted any natural person to acquire a homestead).

210. *In re Owen*, 86 Bankr. at 693. *See* FLA. STAT. ANN. § 222.01 (West 1977) (providing method for individual to designate homestead right granted by state constitution).

211. *In re Owen*, 86 Bankr. at 693.

212. *Id.* at 695.

213. *Id.* at 694.

214. *Id.* (approving line of cases that hold that judicial lien which attached to interest in property prior to debtor's acquisition of that interest is not avoidable pursuant to § 522(f)(1) inasmuch as phrase "an interest of the debtor in property" refers to unencumbered interest at time of acquisition) (citations omitted).

215. *In re Owen*, 877 F.2d 44 (11th Cir. 1989). The court characterizes the debtor's argument in the following cryptic language: "[The debtor] argues that federal law gives him an exemption that state law would not, even though the exemptions in Florida are defined by state law because of its 'opting out' of the federal exemption." *Id.* at 47.

exemption was specifically subject to the prior judgment lien. Thus, section 522(f)(1) was not applicable because there was no impairment of any homestead right protected under Florida law.²¹⁶ The court of appeals decision is wrong. By focusing only on the language of the state exemption statute and not on the underlying values inherent in exemption policy, the *Owen* court deprives the debtor of his human dignity. The Supreme Court has granted certiorari.²¹⁷

In cases like *Owen*, an acknowledgment and awareness of the moral justification for the debtor relief provisions can assist judges and lawyers in attaining the goals sought by Congress.²¹⁸ Exemptions are the heart of the new beginning and represent the nation's compassionate response to economic distress. States have wide latitude in exemption matters.²¹⁹ However, that latitude should not be extended to the detriment of the underlying values inherent in the moral justification for debtor financial relief. The Bankruptcy Code gives state exemptions life in a bankruptcy context.²²⁰ State law may identify the types of property a debtor may exempt from his creditors, define the scope of that protection, and even define the interest in the property that a debtor must have to qualify the property as exempt.

216. *Id.* at 46-47.

217. *Owen v. Owen*, 110 S. Ct. 2166 (1990). The questions presented for review are: (1) whether the lower courts correctly applied § 522(f) based upon the Florida statute which provides that certain judgments or judicial liens create exceptions to otherwise exempt property; (2) whether such a state statute, which creates exceptions to state homestead provisions based upon the time the lien attaches, is permissible when a state has opted out of federal exemptions, when § 522(f) otherwise covers this exception. *Id.*

218. The problems created by state lien conservation statutes and the lack of an understanding, or for that matter, the lack of acknowledgment of the underlying moral justifications of exemptions, has resulted in judicial frustration. See e.g., *In re Snow*, 92 Bankr. 154 (D.C.W.D. Va. 1988), *rev'd*, 899 F.2d 337 (4th Cir. 1990), *petition for cert. filed sub nom. Green v. Snow*, 59 U.S.L.W. 3054 (U.S. July 2, 1990) (No. 90-44). The district judge, feeling constrained to apply the Virginia lien conservation statute, stated that the "result, in this case may seem harsh and indeed is quite unfortunate for the appellee." *In re Snow*, 92 Bankr. at 161. The appellate court reversed holding that § 522(f) could be used to void this lien even in spite of the state's lien conservation statute. *In re Snow*, 899 F.2d at 340. See also *In re Sanderfoot*, 899 F.2d 598, 606 (7th Cir.) (Posner, J., dissenting), *cert. granted sub nom. Farrey v. Sanderfoot*, 111 S. Ct. 507 (1990). Judge Posner noted that the court's decision to void a lien granted by a divorce court relating to the division of property was "a perversion of bankruptcy law, is a product neither of judicial hardheartedness nor legislative ineptitude, but of judicial misunderstanding of the lien avoidance provision of the Bankruptcy Code." *Id.*

219. See e.g., *In re Reed*, 700 F.2d 986, 991 (5th Cir. 1983). In *Reed* the debtor had converted non-exempt personal property into exempt real property on the eve of filing bankruptcy as permitted by state law. The court permitted the exemption under state law but denied the discharge, noting that the entitlement to discharge was to be determined by federal law. The court concluded that "[w]hile the Code requires that, when the debtor claims a state-created exemption, the scope of the claim is determined by state law, it sets separate standards for determining whether the debtor shall be denied a discharge.

220. See, e.g., *In re Ashe*, 712 F.2d 864, 868 (3rd Cir. 1983) (concluding that "[i]n each case [federal or state exemptions], however, it was the federal bankruptcy law which made the exemptions effective."), *cert. denied*, 465 U.S. 1024 (1984).

But once a debtor moves into the bankruptcy process, federal law must dictate a debtor's entitlement to lien avoidance. This approach in fact may result in the creation of an "additional" or "expanded" exemption that would not be available to a debtor under his own state law outside of the bankruptcy context. Thus, if a debtor's property would be exempt under state law, *but for* the presence or existence of a nonpossessory, nonpurchase-money security interest on household goods, or a judicial lien, the debtor should be able to effectuate congressional intent and avoid the lien.²²¹ To hold otherwise permits states to limit the availability of exemptions and to interfere with the humanitarian values inherent in the law, making section 522(f) a nullity.²²² Applying this approach to the *Owen* case makes it clear that the lien can and should be avoided.²²³

221. See *In re Leonard*, 866 F.2d 335, 337 (10th Cir. 1989) (reading legislative history to support conclusion that issue in lien avoidance cases is whether property could have been exempted in absence of lien). In the *Leonard* case the creditors had argued that Colorado by opting out of the federal exemptions had opted out of § 522(f). *Id.* at 336. The court rejected that argument and held that a state may elect to control what property is exempt under state law, but federal law determines the availability of the lien avoidance provision. *Id.* at 337. See also *In re Snow*, 899 F.2d at 340.

222. See *In re Thompson*, 884 F.2d 1100, 1103 (8th Cir. 1989) (holding that in spite of Minnesota's exemption laws, which permit debtor to waive his exemption in specific property by encumbering such property, lien avoidance power under § 522(f) is available to void such liens); *In re Hall*, 752 F.2d 582, 586 (11th Cir. 1985) (noting that while state may be able to determine that lien-encumbered property cannot be exempted, even though it is type of property defined as exempt, this state classification could not prevent debtor from using § 522(f) to avoid liens).

223. Cases involving domestic property settlement agreements create more difficult problems because of the conflict in policies. See *In re Worth*, 100 Bankr. 834, 837 (Bankr. N.D. Tex. 1989). For a detailed discussion of the problems see *In re Sanderfoot*, 899 F.2d at 598 (holding that nondebtor spouse's judicial lien in former marital home for purpose of securing decree obligations was avoidable as impairing debtor's homestead exemption). In *Sanderfoot* the nondebtor spouse's argument that her equitable lien was not a judicial lien under the Code was rejected. *Id.* at 603-05. *But see In re Borman*, 886 F.2d 273, 274 (10th Cir. 1989) (finding that nondebtor spouse retained "equitable lien" and that such lien was not avoidable). In *Borman* the court distinguished its earlier decision in *Maus v. Maus*, 837 F.2d 935, 939 (10th Cir. 1988) (where court had held that implied judicial lien upon homestead was avoidable since divorce court had awarded homestead to debtor free and clear), stating that *Maus* was limited to those situations where a money judgment is awarded to a nondebtor spouse without specifically awarding her a lien on the property. 886 F.2d at 274. Thus, the *Borman* court concluded as long as the divorce judgment does not award the debtor spouse the homestead "free and clear" an equitable lien of the nondebtor spouse exists which can not be avoided under § 522(f). *Id.* Cf. *In re Sanderfoot*, 899 F.2d at 606 (Posner, J., dissenting). Posner, refusing to be drawn into the "equitable lien" argument, stated that the interest of the husband received in the divorce was a limited interest from the beginning because a judicial lien qualified it from the start. *Id.* at 607. Thus, there was no lien impairment of the husband's interest that required avoidance. *Id.* Such an approach, is similar to the approach taken by the *Owen* appellate court and seriously limits the effectiveness of the lien avoidance. The equitable lien approach is, in this author's opinion, consistent with the humanitarian objectives reflected in the fresh start policy. If Congress had intended to permit the avoidance of divorce property settlement equitable liens "we can be certain that there would have been hearings, testimony, and debate concerning consequences so wasteful, so inimical to purposes previously deemed

No doubt, absent the judgment lien, the *Owen* debtor could have claimed the homestead exemption free of encumbrances under Florida law. Also, had the homestead status been obtained prior to the judgment lien, under Florida law the lien would have been ineffective. But in the *Owen* case, the judgment lien was enforceable under Florida law solely because it came into existence before the homestead right. However, contrary to the appellate court decision in *Owen*, nothing in the language²²⁴ of section 522(f)(1) states that the acquisition of property exempt under state law must precede the fixing of the lien in order to be avoided in bankruptcy.²²⁵ To "avoid the fixing of a lien"²²⁶ a debtor must have an "interest in property" as that term is understood under section 541.²²⁷ Furthermore, that interest in property must be of the type to qualify as exempt property under state or federal law. Finally, to be avoided the lien must be a judicial or nonpossessory, nonpurchase-money lien and must prevent the debtor from fully realizing the exemptions which he has declared. No conceivable reading of the word "lien" or the phrase "an interest of the debtor in property" can lead to the conclusion that the timing of the acquisition of the property or the

important, and so likely to arouse public outrage." *TVA v. Hill*, 437 U.S. 153, 209 (1978) (Powell, J., dissenting). See generally Davis, *Equitable Liens and Constructive Trusts in Bankruptcy: Judicial Values and the Limits of Bankruptcy Distribution Policy*, 41 FLA. L. REV. 1 (1989) (discussing problem of equitable claims from perspective of debt collection aspect of bankruptcy policy).

224. The task of resolving a dispute over the statutory language of the Code begins "with the language of the statute itself." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240-41 (1989) (holding from its understanding of plain language of § 506(b) that postpetition interest be paid on all oversecured claims). However, if a literal interpretation of a statute would be at odds with the legislative intent, the courts could in such a rare case disregard the language and implement congressional intent. See *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982). Cf. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) (stating that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code").

225. The majority of Courts have construed the language "the fixing of a lien on an interest of the debtor in property" as implying that the debtor must have acquired the property interest "before" the creditor attached the lien to it. See *In re Keenan*, 106 Bankr. 239, 244 (Bankr. Colo. 1989); *In re Sprick*, 78 Bankr. 292, 295 (Bankr. Kan. 1987); see also *In re Sanderfoot*, 899 F.2d at 607 (Posner, J., dissenting) (asserting that it is "settled in the nonfamily context that a debtor cannot avoid a lien on an interest acquired after the lien attached.") (citations omitted). But see *In re Chandler*, 77 Bankr. 513, 519 (Bankr. E.D. Pa. 1987) (basing decision allowing avoidance on "fresh start" policy), *aff'd*, 1988 WL 34921 (E.D. Pa.).

226. This language is unfortunate, as it implies that the lien which is subject to being avoided has not yet been fixed, and, thus, a debtor could not avoid a lien that was firmly in place at the time of the bankruptcy filing. Such a literal interpretation would make the section meaningless in light of § 362 (automatic stay) and § 549 (trustee can avoid liens place on property of the estate after the filing). However, the statute has never been interpreted so narrowly, and consistently has been applied to existing liens. See, e.g., *In re Thompson*, 867 F.2d at 422 (stating that "the creditor is simply told that if he extends security to a borrower who later goes bankrupt, he may not be able to enforce his security to the hilt"); *In re Brown*, 734 F.2d 119, 124 (2d Cir. 1984).

227. Bankruptcy Code § 541.

attachment of the lien should play any role in the availability of the avoiding power. Nonpossessory, nonpurchase-money liens, or judicial liens, are liens whether they predate or postdate the acquisition of the interest of the debtor. Such liens satisfy the requirements of the statute and can be avoided whenever created.²²⁸ Such a reading of the statute upholds the humanitarian values underlying the grant of exemptions in the Code.²²⁹

228. See *United States v Ron Pair Enterprises, Inc.*, 489 U.S. at 235, 240-41 (stating that statutory interpretation begins with statute's plain language). Cf. *Langley v. FDIC*, 484 U.S. 86, 91 (1987) (refusing to interpret word "agreement" found in Federal Deposit Insurance Act which provided that agreements were not valid to diminish interest of FDIC in acquired assets of failed banks unless agreement met certain conditions, narrowly to include only promises to perform in future).

229. In any event, the Supremacy Clause of the Constitution, U.S. CONST. art. VI, § 2, could be used to void any state law or constitutional provision which restricts or interferes with a debtor's ability to obtain a fresh start. See *Perez v. Campbell*, 402 U.S. 637, 656 (1971) (invalidating Arizona's statute which provided for suspension of driver's license of judgment debtor for nonpayment of judgment for damages resulting from automobile accident even when debt was discharged in bankruptcy because of Supremacy Clause of Constitution); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (noting that in considering validity of state law, Supreme Court's function is to determine if statute stands in way of accomplishing full purposes or objectives of Congress); *Florida v. Mellon*, 273 U.S. 12, 17 (1927) (stating that "[w]henver the constitutional powers of the federal government and those of the state come into conflict, the latter must yield."). This approach has been suggested by other commentators. See Nowka, *supra* note 195, at 164-66 (noting that often Supremacy Clause issue is not properly presented for review and that courts, by focusing on state's authority to define exemptions, attempt to avoid issue); Parkinson, *The Lien Avoidance Section of the Bankruptcy Code: Can It Be Avoided by State Exemption Statutes?* 11 OHIO NORTHERN UNIV. L. REV. 319, 330 (1984).

Thus, a state exemption law that defines exempt property in a way that prevents the application of federal lien avoidance frustrates the full effectiveness of the debtor relief provisions of the Code and is constitutionally invalid. See *Perez v. Campbell*, 402 U.S. 637, 646-48 (holding that state would frustrate congressional policy of fresh start for debtor if permitted to refuse to renew driver's license because tort judgment resulting from automobile accident had been unpaid due to discharge in bankruptcy). This analysis assumes, however, that the particular state law has been authoritatively construed, such that it does in fact prohibit the effective utilization of lien avoidance. *Id.* at 644. In *Owen*, for example, the judgment debt was extinguished as a result of the debtor receiving a discharge. By defining exempt property in a way that prevents the debtor from avoiding the judgment lien on what would otherwise be an exempt homestead, the Florida Constitution and state law jeopardized the "new start 'unhampered by the pressure and discouragement of preexisting debt'" by giving the creditor leverage to collect a discharged judgment debt on otherwise exempt property. *Id.* at 649 (citation omitted in original). State laws which permit creditors to circumvent effectively the fresh start policy of § 522(f) undermine the federal policy of fresh start and, thus, fall under this stricter constitutional standard. See *id.* Cf. *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918) (stating that "[i]t is only state laws which conflict with the bankruptcy laws of Congress that are suspended; those which are in aid of the Bankruptcy Act can stand."). Given the reluctance of the Supreme Court to reach constitutional issues, the Court can arrive at the same result by interpreting § 522(f) in light of the humanitarian values inherent in the debtor financial relief provisions of the Code. See *Ashwander v. TVA*, 297 U.S. 288, 346-48 (1936) (Brandeis, J., concurring). Justice Brandeis lists seven rules under which the Supreme Court has avoided passing upon a large part of the constitutional questions raised. Rule 4 has practical import for the issue addressed by lien conservation statutes.

The Court will not pass upon a constitutional question although properly presented

THE STANDARD OF PROOF IN DISCHARGE CASES

While society should act in a humanitarian manner toward the debtor, the debtor is obligated to deal fairly with his creditors. When the debtor allegedly defrauds creditors, the issue arises as to the proper standard of proof that the courts should apply. The function of the burden of proof is to instruct the factfinder concerning the degree of certainty of factual conclusions that society thinks it should have for a particular type of legal situation.²³⁰ The standard serves to distribute risks of mistake in factfinding between the litigants and to indicate the relative importance of the ultimate decision.²³¹ The conventional rule in civil litigation is that the party with the burden of proof needs only to prove his case by a preponderance of the evidence.²³² The effect of such a level of proof is that the parties share the risk of juror error in roughly equal fashion. However, the Supreme Court has required that a higher standard of proof—the clear and convincing standard—be used in certain types of constitutional litigation involving individual rights.²³³ At the close of the last century the Supreme Court also

by the record, if there is also present some other ground upon which the case may be disposed of. This rule has found most varied application. Thus, if a case can be decided on either of two grounds, one involving a constitutional question, the other a question of statutory construction or general law, the Court will decide only the latter.

Id. at 347 (citations omitted).

230. See *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring). In Harlan's view, the choice of the standard in any particular adjudication reflects "a very fundamental assessment of the comparative social costs of erroneous factual determinations." *Id.* at 370. Harlan notes that two separate and distinct propositions support his assertion. First, a factfinder may be unable to determine "unassailably accurate" information to determine a disputed fact. *Id.* Thus, the factfinder can only form a belief of what probably happened. *Id.* Secondly, a factfinder may be wrong about his factual conclusions. *Id.* "Because the standard of proof affects the comparative frequency of these two types of erroneous outcomes, the choice of the standard to be applied in a particular kind of litigation should, in a rational world, reflect an assessment of the comparative social disutility of each." *Id.* at 371. Thus, under Harlan's analysis, a lesser standard is appropriate in civil litigation because errors in civil litigation are not deemed "serious" from society's viewpoint. *Id.* at 371-72. In criminal cases, the stricter standard is imposed "on a fundamental value determination of our society that it is far worse to convict an innocent man than to let a guilty man go free." *Id.* at 372.

231. *Addington v. Texas*, 441 U.S. 418, 423 (1979).

232. *Price Waterhouse v. Hopkins*, 490 U.S. 228 (1989).

233. See *Santosky v. Kramer*, 455 U.S. 745, 768-69 (1982) (holding that Fourteenth Amendment requires more than fair preponderance of evidence in terminating parent-child relationships); *Addington*, 441 U.S. at 427 (holding that Fourteenth Amendment requires more than preponderance of evidence in involuntary civil commitment procedures); *Schneiderman v. United States*, 320 U.S. 118, 125, 159 (1943) (holding that Fourteenth Amendment requires clear and convincing standard in denaturalization proceedings). *But see Vance v. Terrazas*, 444 U.S. 252, 266-67 (1980) (holding that Due Process Clause does not require proof beyond preponderance of evidence in expatriation hearing); *United States v. Regan*, 232 U.S. 37, 48-49 (1914) (holding that preponderance of evidence suffices in civil suits involving proof of acts that expose party to criminal misdemeanor prosecution). The Supreme Court has also held that the clear and convincing standard is constitutionally required in cases of defamation. *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 342 (1974).

had required a higher standard of proof in certain equity proceedings to set aside written instruments by reason of fraud.²³⁴ Any standard other than a preponderance of the evidence creates a bias in favor of one side of the litigation. Thus, the resolution of the issue in the bankruptcy context depends on whether the moral justification for debtor financial relief substantiates a bias in favor of the debtor. The values inherent in the justification answer a resounding no.

Under the Bankruptcy Code and the rules prescribed²³⁵ by the Supreme Court, upon the filing of a bankruptcy petition creditors must act to prevent the discharge of a debt.²³⁶ If a debt is not discharged, the "fresh start" of a debtor will be hindered because the debtor would not receive the full humanitarian benefits of the bankruptcy process. On the other hand, the ethical obligations imposed upon a debtor as a member of society create a covenant relationship that imposes a fair dealing requirement on the part of the debtor that can justify the nondischargeability of certain debts. However, a failure to analyze issues involving dischargeability in these terms has led to much ad hoc decision making. Nowhere has this random decision-making been more pronounced in recent years than in the area of the level

234. See *United States v. American Bell Tel. Co.*, 167 U.S. 224, 240-41 (1897). The continued validity of these early common law fraud decisions is highly questionable. More recently, the Supreme Court, discussing the level of proof needed in statutory fraud cases under the Securities Exchange Act, noted that "the historical considerations underlying the imposition of a higher standard of proof [in civil fraud actions at common law] have questionable pertinence [in cases under the Exchange Act]." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388 (1983). The *Huddleston* Court went on to hold that defrauded purchasers of stock seeking to recover under the Act need to prove their case only by a preponderance of evidence. *Id.* at 390-91. See also *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943) (stating that fraud can be established under the Securities Act of 1933 by preponderance of evidence). The Court also has noted that in civil cases "[e]xceptions to this standard [preponderance of the evidence] are uncommon, and in fact are ordinarily recognized only when the government seeks to take unusual coercive action . . ." *Price Waterhouse v. Hopkins*, 490 U.S. 228, 253.

235. See 28 U.S.C. § 2075 (1982).

236. Section 523 limits the scope of discharge for an individual debtor for certain specific types of debts. However, § 523(c) states:

Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2) [false financial statements], (4) [fraud while acting in a fiduciary capacity], or (6) [willful and malicious injury] of subsection (a) of this section, unless, on request of the creditor to whom such a debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2),(4), or (6), as the case may be, of subsection (a) of this section.

Under Bankruptcy Rule 4007, a complaint to determine the dischargeability of a specific debt in a Chapter 7 proceeding may be brought at any time, except objections under § 523(a)(2), (4), and (6), which must be brought within 60 days following the first date set for the meeting of creditors. Bankruptcy Rule 4007(d) provides that the court shall set a time for the filing of complaints to determine the dischargeability of a debt pursuant to § 523(c) upon the filing of a motion for a hardship discharge under Chapter 13. See Bankruptcy Code § 1328(b) (providing that court may, under certain specified conditions, grant individual debtor a discharge similar to that in Chapter 7, if debtor has not completed payments under Chapter 13 plan).

or standard of proof²³⁷ in dischargeability matters under section 523(c).²³⁸ In choosing between whether a creditor must establish his objection by a preponderance of the evidence or by clear and convincing evidence, a few courts have "punted,"²³⁹ while others have selected one or the other standard without offering a rationale for their decision.²⁴⁰ On the other hand, some courts have attempted to articulate justifications for different standards of proof depending on the type of debt being discharged.²⁴¹ Still other courts

237. Bankruptcy Rule 4005 provides: "At the trial on a complaint objecting to a discharge, the plaintiff has the burden of proving the objection." No rule states who has the burden of proof in the complaint to determine the dischargeability of a debt. Case law establishes that the party objecting to the discharge of the debt has the burden of persuasion on the objection. See *Hill v. Smith*, 260 U.S. 592, 595 (1923). See *infra* text accompanying notes 264-66.

238. See *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262 (11th Cir. 1988) (accepting tacitly clear and convincing standard), abrogated by *Grogan v. Garner*, 111 S. Ct. 654 (1991); *Combs v. Richardson*, 838 F.2d 112, 116 (adopting preponderance of evidence standard). Objections to the discharge of a debt giving rise to a standard of proof problem can arise in two different factual scenarios. The first involves situations where the underlying debt was not the subject of an earlier court proceeding, or the doctrine of collateral estoppel is not applicable. In these cases the court need only determine the correct standard of proof. On the other hand, the alleged nondischargeable debt may be the result of an earlier judgment where the creditor in the dischargeability proceeding is asserting the doctrine of collateral estoppel. In the latter type of situations the standard of proof issue revolves around concerns that the standard used in the earlier proceeding is different from that which should be used in the dischargeability proceeding. Disparate standards of proof would foreclose the application of the doctrine of issue preclusion. In *re Braen*, 900 F.2d 621, 624 (3d Cir. 1990), *cert. denied sub nom. Braen v. Lagenella*, 111 S. Ct. 782 (1991). Thus, for example, if the nonbankruptcy court used a lesser standard of proof than would be required by § 523, collateral estoppel would not apply in the bankruptcy proceeding.

239. Courts "punt" when they avoid the standard of proof issue by claiming merely that the plaintiff has not met even the lower standard. In *re Watkins*, 90 Bankr. 848, 851 n.7 (Bankr. E.D. Mich. 1988). The field is further obscured by the fact that other courts have avoided the issue by reverse decision making.

When courts have decided in favor of the defendant/debtor they simply state that the plaintiff has failed to prove its case by even a preponderance of the evidence.

When they have decided in favor of the plaintiff/creditor they say that the case was proved by clear and convincing evidence.

In *re Stowell*, 102 Bankr. 589, 596 (Bankr. W.D. Tex. 1989), vacated in part by 113 Bankr. 322 (Bankr. W.D. Tex. 1990).

240. See *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986) (holding that in case where creditor objected to discharge of debt on grounds of false representations, burden is on debtor to prove debtor's culpability by clear and convincing evidence), abrogated by *Grogan v. Garner*, 111 S. Ct. 654 (1991). This approach is no different than one of the commentators who states without explanation that the appropriate burden of proof is the clear and convincing standard. See 3 COLLIER'S ON BANKRUPTCY, ¶ 523.08 (15th ed. 1989).

241. See *In re Braen*, 900 F.2d at 625-26 (stating that "the burden of proof under § 523 is the prevailing standard used by courts to resolve the types of claims underlying the particular exception at issue"), *cert. denied sub nom. Braen v. Lagenella*, 111 S. Ct. 782 (1991). In *Braen* the court held that under § 523(a)(6) the creditor only need a malicious and willful injury inflicted by the debtor by a preponderance of the evidence. *Id.* at 626. However, in dicta the court noted that in disputes relating the dischargeability under § 523(a)(2)—the exception for indebtedness arising out of fraud—that the clear and convincing standard was appropriate. *Id.* at 625.

have given lip service to general concepts of "honesty"²⁴² and "fresh start"²⁴³ with little if any critical analysis of the underlying justification in finding in favor of the debtor.²⁴⁴

The *Garner* case exemplifies the confusion in the courts. In *Grogan v. Garner* a federal jury found that Frank Garner had committed common-law fraud, breached his fiduciary capacity, and violated section 10(b) of the Securities Exchange Act.²⁴⁵ Shortly before the judgment was affirmed, Garner sought relief under Chapter 11 of the Code listing the judgment as a dischargeable debt. An adversary proceeding²⁴⁶ was brought to determine the dischargeability of the debt, alleging that the judgment debt was non-dischargeable under section 523(a)(2).²⁴⁷ The debtor alleged that because the creditors were permitted to establish fraud at the trial level by a preponderance of the evidence standard, the debtor was entitled to a new trial on the issue of fraud at the dischargeability proceeding. The debtor's argument was based upon his assertion that fraud must be established by clear and convincing evidence to escape discharge.²⁴⁸ The bankruptcy court rejected this argument and held that the trial judgment collaterally

242. See *In re Phillips*, 804 F.2d 930, 933 (6th Cir. 1986), abrogated by *Grogan v. Garner*, 111 S. Ct. 654 (1991); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986), abrogated by *Grogan v. Garner*, 111 S. Ct. 654 (1991).

243. See *In re Foreman*, 906 F.2d 123, 127 (5th Cir. 1990); *In re Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987).

244. See *In re Garner*, 881 F.2d 579, 582 (8th Cir. 1989) (construing Code's discharge provisions broadly in favor of debtor to avoid facing more difficult problem of discerning underlying congressional justification for exceptions to discharge), *rev'd sub nom.* *Grogan v. Garner*, 111 S. Ct. 654 (1991).

245. *Grogan v. Garner*, 806 F.2d 829 (8th Cir. 1986). The appellate court in *Grogan* held that the plaintiffs were entitled to one award of damages under either § 10(b) or common law fraud, whichever was greater. *Id.* at 839. Because punitive damages were permitted under the common law recovery, but not under the federal securities claim, the plaintiffs elected to pursue only the fraud claim. *In re Garner*, 73 Bankr. 26, 27 (Bankr. W.D. Mo. 1987), *aff'd sub nom.* *Henson v. Garner*, No. 87-0434-CV-W-1 (W.D. Mo. Feb. 29, 1988), *rev'd sub nom.* *In re Garner*, 881 F.2d 579 (8th Cir. 1989), *rev'd sub nom.* *Grogan v. Garner*, 111 S. Ct. 654 (1991).

246. See Bankruptcy Rule 7001 (identifying proceeding to determine dischargeability of debt as adversary proceeding). Adversary proceedings are full blown federal lawsuits within the larger bankruptcy case. Contested matters are disputes other than adversary disputes and are subject to the less elaborate procedures of Bankruptcy Rule 9014.

247. Under § 1141(d)(2) the confirmation of a Chapter 11 plan does not discharge an individual debtor from any debts excepted from discharge under § 523. Bankruptcy Code § 1141(d)(2).

248. There are two generally recognized standards or levels of proof in civil cases. In the typical civil case for money damages a plaintiff must prove his case by a preponderance of the evidence, meaning the great weight and degree of the credible evidence. See *Addington v. Texas*, 441 U.S. 418, 423 (1979) (stating that "[s]ince society has a minimal concern with the outcome of such private suits, plaintiff's burden of proof is a mere preponderance of the evidence."). The effect of such a standard is that the parties share the risk of juror error in roughly equal fashion. *Id.* A higher standard of proof, which courts term "clear and convincing," is used in some civil litigation where the "interests at stake are deemed more substantial than mere loss of money." *Id.* at 424.

estopped²⁴⁹ the relitigation of the issue of fraud.²⁵⁰ Thus, the debt that had been satisfactorily established at the trial level²⁵¹ was nondischargeable. The United States District Court for the Western District of Missouri

249. See *Brown v. Felson*, 442 U.S. 127, 138-39 (1979) (rejecting application of doctrine of res judicata to questions of dischargeability addressed in state court judgment because exclusive jurisdiction for such issues lies in bankruptcy court). The *Brown* Court, however, in a footnote and by way of dicta noted that "[i]f, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17 [of the Bankruptcy Act which is the predecessor to § 523 of the present Code], then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court." *Id.* at 139 n.10. See also *Heiser v. Woodruff*, 327 U.S. 726, 736 (1946) (holding that bankruptcy court should give effect to prior state court judgment based on fraud and not allow relitigation of issue in objection to claim procedure under Bankruptcy Act).

Following *Brown* several circuit courts have held that the doctrine of issue preclusion applies to dischargeability litigation in bankruptcy court. See, e.g., *Wheeler v. Laudani*, 783 F.2d 610, 615 (6th Cir. 1986); *In re Shuler*, 722 F.2d 1253, 1256 (5th Cir.), cert. denied sub nom. *Harold V. Simpson & Co. v. Shuler*, 469 U.S. 817 (1984); *Spilman v. Harley*, 656 F.2d 224, 228 (6th Cir. 1981). Under the approach of these courts, if the circumstances meet all the requirements for the application of the doctrine, collateral estoppel should prevent the relitigation of factual issues, while leaving to a bankruptcy court the determination of the legal issue of dischargeability. In *Marrese v. American Acad. of Orthopaedic Surgeons*, 470 U.S. 373 (1985), the Supreme Court held that the full faith and credit statute (28 U.S.C. § 1738 (1982)) requires that "state law determine at least the issue of preclusive effect of a prior state court judgment in subsequent action involving a claim within the exclusive jurisdiction of the federal courts," except in those circumstances where federal policy dictates an exception to the full faith and credit statute. *Id.* at 381. In such a case the federal rule of issue preclusion would prevail.

In the area of dischargeability proceedings, no consensus exists as to whether federal policy dictates an exception. Compare *In re Hall*, 95 Bankr. 553, 555 (Bankr. E.D. Tenn. 1989) (applying a federal rule of collateral estoppel) with *In re Byard*, 47 Bankr. 700, 706 (Bankr. M.D. Tenn. 1985) (applying a state rule of collateral estoppel). For purposes of this article it is not necessary to determine whether the requirements of collateral estoppel are governed by a federal or a state rule, but only that the doctrine is applicable. Thus, the focus turns to the proper level of proof required to initiate the application of the doctrine under either a federal or state standard.

250. *In re Garner*, 73 Bankr. 26, 28 (Bankr. W.D. Mo. 1987). In *Garner* Judge Koger relied heavily upon an opinion by Chief Bankruptcy Judge Steward of the same judicial district that discussed the applicability of evidentiary standards to § 523 litigation. *Id.* at 29 (citing *In re Curl*, 49 Bankr. 302, [304-06 n.6] (Bankr. W.D. Mo. 1984)). Judge Koger, however, erroneously concluded by stating "that there is no real distinction between 'preponderance of the evidence' and 'clear and convincing' as regards to 523 litigation." *Garner*, 73 Bankr. at 29. In *Curl* Judge Steward had not reached this conclusion, but had opined that although cases and commentary suggested that the clear and convincing standard was required in cases involving the discharge under 523(a)(2) (cases involving fraud), that the authorities cited by these cases and commentators failed to support the proposition. *Curl*, 49 Bankr. at 305-06, n.6. However, to avoid possible error in this regard, Judge Steward applied the clear and convincing standard. *Id.* In *Garner* Judge Koger did not reach the dischargeability of the other counts in the original complaint because two of the counts presented dischargeable debts. *Garner*, 73 Bankr. at 29. The other (breach of fiduciary obligation) was not considered, because the creditors elected to recover under the fraud count. *Id.*

251. The creditor presented as evidence, *inter alia*, the jury verdict and the trial court judgment, then rested. *Garner*, 73 Bankr. at 27.

affirmed in an unreported decision.²⁵² Feeling constrained by earlier circuit court opinions,²⁵³ the court of appeals reversed, holding that the judgment debtor was not estopped from contesting the dischargeability of the debt because of the disparate standards of proof.²⁵⁴ In doing so the court casually observed that because the higher standard of proof protects the fresh start policy, courts should construe broadly provisions of the Code favoring the debtor.²⁵⁵

The Supreme Court reversed the decision of the court of appeals holding that the preponderance of the evidence standard applied to all of the discharge exceptions provided in section 523(a).²⁵⁶ In *Garner* Mr. Justice Stevens writing for a unanimous Court asserted that the preponderance of the evidence standard reflected a "fair balance" between the conflicting interests of debtors' desire for fresh start and creditors' demand for repayment in full of debts excluded by Congress from discharge.²⁵⁷ However, instead of then articulating the underlying values inherent in its decision, the Court enunciated several other plausible reasons for what then became an ad hoc decision.²⁵⁸ As his predecessors on the Court, Justice Stevens fails to clearly articulate the underlying values involved in the case. His

252. *Henson v. Garner*, No. 87-0434-CV-W-1 (W.D. Mo. Feb. 29, 1988).

253. See *Matter of Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987) abrogated by *Grogan v. Garner*, 111 S. Ct. 654 (1991).

254. *In re Garner*, 881 F.2d 579, 581-82 (8th Cir. 1989).

255. *Id.* at 582. The *Garner* court stated that applying a preponderance of the evidence standard to the question of the dischargeability of a debt sounding in fraud would effectively read the fresh start policy out of the Code. *Id.* The court stated: "We do not believe that principles of statutory construction dictate such a reading where Congress has not expressly announced a contrary result." *Id.* The *Garner* court specifically rejected an earlier Fourth Circuit opinion that had held that exceptions to discharge contained in § 523(a)(6)—willful and malicious acts—are governed by the preponderance of the evidence standard. *Id.* But see *Combs v. Richardson*, 838 F.2d 112, 116 (4th Cir. 1988) (holding that exceptions to discharge in § 523(a)(6) are subject to preponderance of evidence standard). In *Combs* the court in dicta noted that no heightened burden of proof was necessary for any of the dischargeability exceptions. *Id.*

256. *Grogan v. Garner*, 111 S. Ct. 654, 661 (1991).

257. *Id.* at 659.

258. *Id.* at 659-61. Justice Stevens correctly notes that since Congress did not distinguish between the burden of proof in the various exceptions to discharge under § 523(a) that the same standard must logically apply to each exception to discharge. He determined that since the preponderance of the evidence standard applies in several of the nondischargeable debts that "it is fair to infer that Congress intended the ordinary preponderance standard to govern the applicability of all the discharge exceptions." *Id.* at 660. Justice Stevens then observed that Congress has chosen by statute the preponderance of the evidence standard in other substantive fraud causes of action. He then stated that the preponderance of the evidence standard was used by many courts in the fraud discharge exception of the Bankruptcy Act following the amendments to the Act in 1970 which made questions of nondischargeability a federal question. Finally he noted that such a standard would permit an exception of discharge for all fraud claims reduced to judgment regardless of the standard used in the state where the judgment was rendered. He concluded by holding that for all of these reasons (including the fair balance of conflicting interests) the preponderance of the evidence standard is the proper standard of proof in dischargeability proceedings.

brief discussion of conflicting interests could have been a launching pad for a discussion of the duality of the moral justification. But suffice it to say, the present Court prefers to hide behind a mantle of logic and semantics and refuses to seriously address the ultimate values inherent in its decisions. As a result the Court gives little, if any, substantive guidance to lower courts.

The Bankruptcy Code and the Bankruptcy Rules prescribe no standard. As Congress has not authorized an appropriate standard and the Constitution does not dictate one,²⁵⁹ the court must prescribe one.²⁶⁰ The legislative history of the Code is silent. To postulate that Congress, without expressly stipulating, expected bankruptcy courts to apply different standards of proof to each of the various types of dischargeable debts, or for that matter to apply a different standard for any one class of dischargeable debts, defies logic. To attribute to Congress, in the absence of explicit instruction, a requirement for the relitigation of a judgment debt of the type listed as nondischargeable is also unreasonable. Finally, to envision that Congress wanted the courts to use one unidentified standard of proof in dischargeability matters (or in some dischargeability matters) and another unidentified standard in other adversary or contested matters defies imagination.²⁶¹ This is especially true given the fact that the lower standard is uniformly used in civil litigation. It is only reasonable then to suspect that one standard or level of proof is to apply across the board.

259. See *United States v. Kras*, 409 U.S. 434, 446 (1973) (declaring that “[t]here is no constitutional right to obtain a discharge of one’s debts in bankruptcy.”). In *Kras* the Court held that the payment of a filing fee as a prerequisite to receiving a discharge under the Bankruptcy Act did not violate any protections guaranteed by the Fifth Amendment. *Id.* at 450.

260. See *Steadman v. SEC*, 450 U.S. 91, 95 (1981) (holding that where legislation does not prescribe and Constitution does not dictate burden of proof standard, Supreme Court must prescribe standard). In *Steadman* the Court sustained the use of a preponderance of the evidence standard in SEC administrative proceedings aimed at permanently barring an individual from practicing his profession for violations of the antifraud provisions of the Securities and Exchange Act. *Id.* at 102.

261. The preponderance of the evidence standard of proof is used uniformly in other areas of bankruptcy litigation. See, e.g., *Constructora Maza, Inc. v. Banco de Ponce*, 616 F.2d 573, 576 (1st Cir. 1980) (holding preponderance of evidence sufficient in proceeding to recover voidable preference under Bankruptcy Act); *Green v. A. G. Edwards & Sons, Inc.*, 582 F.2d 439, 442 (8th Cir. 1978) (requiring that, in preference action under Bankruptcy Act, trustee establish by preponderance of evidence that creditor had reasonable cause to believe debtor was insolvent at time of transfer); *In re Mascolo*, 505 F.2d 274, 276 (1st Cir. 1974) (holding that fair preponderance of evidence is sufficient standard in proceeding to revoke discharge for false oath under Bankruptcy Act); *In re Ayala*, 107 Bankr. 271, 274 (Bankr. E.D. Cal. 1989) (requiring holding preponderance of evidence sufficient to prevent discharge in § 727 case involving transfers to defraud creditors); *In re Magnus*, 84 Bankr. 976, 978 (Bankr. E.D. Pa. 1988) (party objecting to debtor’s claimed exemptions to prove grounds for objection by preponderance of evidence); *In re Riso*, 74 Bankr. 750, 757 (Bankr. D.N.H. 1987) (holding preponderance of evidence sufficient to prevent discharge for defrauding creditors under § 727 and opining that same standard should apply in all cases involving objections to discharge).

The philosophical framework presented here offers useful insight for replacing this arbitrary decision-making process and leads to a systematic and coherent solution to the issue. The solution process involves integrating the moral justification of debtor financial relief into a burden of proof framework.

The covenant relationship which is at the heart of the moral justification for debtor financial relief has two equally significant value components. The first is the humanitarian response of society to forgive existing financial obligations in order to preserve the dignity of a debtor, to insulate his family from his misfortunes, and to provide an impetus to industry by freeing human capital. On the other hand, each debtor has an implied covenant with society that his dealings giving rise to his financial obligations are based on fair dealing.²⁶² These two separate and distinct underlying sets of values need to be understood and acknowledged to reach effectively the goals that Congress sought to achieve through the implementation of debtor financial relief.²⁶³

By prescribing a higher standard of proof, one is making a subjective value judgment that one of the separate and distinct values is more important than the other.²⁶⁴ Such an approach presupposes the very fairness which is at issue²⁶⁵ and places a presumption in favor of the humanitarian set of values over the value of fair dealing. Thus, the selection of a standard of proof reflects an ultimate societal decision. By selecting a clear and convincing standard a court would be asserting that society's humanitarian justification of discharge outweighs an individual creditor's right to commutative justice. Under the moral justification for the financial rehabilitation

262. See *Fidelity & Deposit Co. of Md. v. Arenz*, 290 U.S. 66, 69 (1933) (stating that Bankruptcy Act conditions discharge upon applicant's adherence to standards of honesty and fair dealing); *Chapman v. Forsyth*, 43 U.S. (2 How.) 202, 207 (1844) (stating that "[i]t was proper that Congress [in enacting the 1841 Act] should not relieve from debts which had been incurred by a violation of good faith, whilst, from other obligations a full discharge to the same person should be given.").

263. The continued failure of courts to acknowledge the mutual covenant concept which underlies the moral justification for fresh start creates serious problems in these courts' analyses. See, e.g., *In re Braen*, 900 F.2d 621, 625 (3rd Cir. 1990) (expressing belief that "'fresh start' policy underlying the Code provides no help in determining what Congress intended regarding standards of proof"), *cert. denied sub nom. Braen v. Laganella*, 111 S. Ct. 782 (1991). The fundamental problem might lie in the fact that the continued use of buzz words such as "fresh start" distort the proper focus. Howard, *supra* note 20, at 1048. However, by developing an awareness of the duality of the moral justification, these semantic difficulties can be overcome.

264. Unless and until courts confront the significant legal issues head-on and discuss the underlying "whys" and "whats" behind a particular policy, court decision making is relegated to the subjective whim of the decision maker. See Moore, *supra* note 53, at 1154-56 (discussing various ways values do and must enter into legal reasoning and noting that a moral realist can put aside her personal values in decision making).

265. *In re Powell*, 88 Bankr. 114, 118 (Bankr. W.D. Tex. 1988) (suggesting that use of higher standard of proof presumes honesty of creditor which is very issue in discharge and dischargeability cases).

of debtors, the obligation of a debtor to his creditors in terms of fair dealing is of equal weight and presumptive validity to society's humanitarian response to a debtor.²⁶⁶ Any other solution is inconsistent with the Grisez-Finnis approach to the resolution because it would place undue emphasis on one human good or value to the detriment of another.²⁶⁷ The rules of practical reason and values underlying a moral approach to bankruptcy dictate the lesser standard.

CONCLUSION

This article has attempted to develop an awareness of the moral justification for debtor financial relief. America, as it approaches the twenty-first century, is an enlightened country whose moral fiber has undergone drastic changes over time, such that on any particular ethical issue confronting the nation, it is difficult, if not impossible, to ascertain a fiber of moral consensus. One notable exception is in the area of social justice and the insolvent. Historically, this nation has recognized an objective moral dimension to the bankruptcy process, and Congress continually has enacted legislation implementing its fresh start policy, which strives to obtain goals that mirror that moral fiber. This article has shown that this fiber is composed of two separate but mutually dependent strands of values intertwined into a coherent plan of debtor financial relief. The first strand reflects the humanitarian concerns of the nation by stressing the fundamental dignity of every individual. This strand acknowledges a nation's awareness that the basic economic conditions of human well-being are essential to society's continued existence and are due members of society as inalienable

266. This position is not inconsistent with decisions of the Supreme Court which have confined exceptions to discharge to those plainly enumerated. See *Gleason v. Thaw*, 236 U.S. 558, 562 (1915). In *Thaw* the Court, in discussing the exception to discharge relating to obtaining property by false pretenses found in the Bankruptcy Act, held that the professional services of an attorney were not property under that provision and thus, the debt for such services would be dischargeable. *Id.* at 561-62. Nor for that matter is the *Thaw* approach inconsistent with the approach pronounced by the Supreme Court in *Neal v. Clark*, 95 U.S. 704 (1878). In construing the 1867 Act by the application of well defined rules of construction, the Court held that the word "fraud" used in the section of the Act that set forth the classes of debts which were exempted from the operation of discharge referred to positive fraud, not constructive fraud. *Id.* at 709. The Court, continuing by way of dicta, observed that "[a] different construction would be inconsistent with the liberal spirit which pervades the entire bankruptcy system." *Id.* A leading commentator cites *Neal* as additional source material for the proposition that exception to discharge "should be strictly construed against the objecting creditor and liberally in favor of the debtor." 3 *COLLIERS ON BANKRUPTCY* § 523.05A (15th ed. 1988). However, this is not the holding of the *Neal* case. Furthermore, this position erroneously would place the values inherent in discharge above the values inherent in the system of commutative justice.

267. J. FINNIS, *NATURAL LAW*, *supra* note 23, at 127. Finnis notes that the exclusive attention to one basic value or basic requirement of practical reasonableness and inattention to others can be considered to be distorted as a result of "uncritical, unintelligent spontaneity" or perhaps a bias induced by "social practice" or "emotion" that resists the concern to be reasonable. *Id.*

rights. The second strand symbolizes the recognition by a debtor that in return for such rights he has the duty and obligation to deal fairly with individual members of the nation. Together these intertwined strands form the roots of an underlying moral foundation for debtor financial relief. These strands of mutual covenant signify the greatness of a nation that rejects economic action as an end in itself, and seeks justification on a higher plane. On this plane "*[t]he dignity of the human person, realized in community with others, is the criterion against which all aspects of economic life [including the bankruptcy laws] must be measured.*"²⁶⁸

268. BISHOPS' LETTER, *supra* note 24, at 14 (emphasis in original).

Addendum

On May 23, 1991, the Supreme Court reversed the decision of the court of appeals in the *Owen* case²⁶⁹, holding that a judicial lien could be avoided notwithstanding Florida's law that defined exempt property to "specifically excluded property encumbered by judicial liens."²⁷⁰ Mr. Justice Scalia writing for the majority asserted that the avoidance power was available for an interest in property of the debtor that, but for the lien, would be exempt.²⁷¹ Thus, even though pre-existing judicial liens are an exception to the Florida homestead exemption, a debtor might be able to circumvent Florida's lien conservation statute and avoid a pre-existing judicial lien. The case was remanded to the circuit court to resolve the issue of whether the lien could be avoided under the facts of the case.²⁷² The "result" in *Owen* is consistent with the moral justification for debtor financial relief. However, the opinion is devoid of any underlying value discussion.

In resolving the legal issue on remand, however, the appellate court will be guided by the Court's decision in *Farrey v. Sanderfoot*²⁷³ issued on the same days as the *Owen* decision. In *Farrey* the Court held that the lien avoidance section required a debtor to have possessed an interest in property

269. *Owen v. Owen*, 1991 WL 83032, 6 (U.S.). See *supra* notes 206-17 and accompanying text (discussing decisions of lower courts).

270. *Owen*, 1991 WL.

271. The Court observed that the adoption of this approach in the case of state exemptions would be consonant with the current treatment in the case of federal exemptions. *Id.* at 4 (stating that approach taken by lower courts in area of federal exemptions is "not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he would be entitled but for the lien itself."). The Court noted that "the question is whether the lien impairs an 'exemption to which the debtor would be entitled under subsection (b) [§ 522(b)],' and under subsection (b) [Section 522(b)], exempt property is determined 'on the date of the filing of the petition, not when the lien fixed.'" *Id.* at 5 n.6. In his dissent Justice Stevens argued that the issue of whether the debtor would have been entitled to the exemption is addressed to the state of affairs that existed at the time the lien attached, not at the time of filing the petition. *Id.* at 9. Thus, under his analysis, the debtor could not avoid the lien because at the time the lien attached, the debtor was not entitled under Florida law to a homestead exemption. *Id.* at 10.

272. *Id.* at 6. In order to avoid the lien, the debtor would have to establish that under Florida law he had an interest in property prior to the fixing of the lien. If he had acquired the property subject to the lien, or if the lien had attached simultaneously with his acquisition of the property, the Court observed that it could be argued that the lien did not fix on an interest of the debtor in property and thus, the lien could not be avoided. This issue was not addressed by the Court for the reason, that for purposes of its decision, the Court assumed that the judicial lien in this case fixed on an interest of the debtor in property. *Id.* at 3. The subsidiary issue of whether the retroactive application of the homestead exemption in Florida would be an unconstitutional taking, if the lien was avoided, also was reserved for consideration by the appellate court. The Court had previously avoided a similar issue by holding that § 522(f) did not apply retroactively to liens that had been perfected before the enactment of the Code. *United States v. Security Indus. Bank*, 459 U.S. 70, 81 (1982).

273. *Farrey v. Sanderfoot*, 1991 WL 83070 (U.S.).

to which the lien attached, before the lien itself attached.²⁷⁴ Mr. Justice White, writing for the majority, stressed the "purpose" of the lien avoidance section as reflected in the legislative history,²⁷⁵ but, like Justice Scalia in the *Owen* opinion, failed to give any consideration to the values underlying our present bankruptcy system. Thus, the Court remains sequestered in its mantle of logic and semantics. Nevertheless, a careful reading of facts in *Farrey*²⁷⁶ and the only three cases²⁷⁷ relied upon by Court to support its decision reveal one common thread—the debtor who was attempting to avoid the lien had breached the implied covenant of fair dealing inherent in the moral justification for debtor financial relief.²⁷⁸ Under the Grisez-Finnis approach this breach justifies the denial of lien avoidance. The humanitarian response of society in such cases must be tempered by an

274. Justice White, following Judge Posner's dissent in the appellate decision, asserted that lien avoidance applied only where the judicial lien attached to the debtor's interest at some point after the debtor had obtained the interest. It is disappointing that the court did not discuss the possibility of resolving this issue on the basis of an equitable lien as opposed to a judicial lien. However, the court noted that *Farrey* did not challenge the lower courts determination that this was a judicial lien. *Id.* at 3. Justice Kennedy, concurring, observed that the decision of the majority was consistent with fairness and common sense. *Id.* at 8. However, Justice Kennedy was concerned that artful divorce lawyers could avoid the effects of the decision and that Congressional action was necessary. *Id.* See *supra* notes 218 and 223 for a brief discussion of the appellate court's decision in *Farrey*.

275. *Id.* at 6 (explaining that purpose of § 522(f)(1) was "to thwart creditors who, sensing an impending bankruptcy, rush to court to obtain a judgment to defeat the debtor's exemptions.").

276. In *Farrey* the divorce decree, which was entered on February 5, 1987, awarded Sanderfoot (subsequently the debtor) sole title to the former family house and simultaneously granted his former spouse (*Farrey*) a lien on the house to secure payments that Sanderfoot was to make to her. *Id.* at 2. Sanderfoot never made "the required payments nor complied with any other order of the state court". *Id.* Instead, he filed bankruptcy on May 4, 1987. *Id.*

277. *In re McCormick*, 18 Bankr. 911, 914 (Bankr. W.D. Pa. 1982), *aff'd sub nom.* *McCormick v. Mid-State Bank & Trust Co.*, 22 Bankr. 997 (W.D. Pa. 1982) (holding that judgment lien existed on residence held as tenants by entirety by husband and wife and subsequent transfer by husband to wife of his interest was subject to existing lien); *In re Stephens*, 15 Bankr. 485, 486 (Bankr. W.D. N.C. 1981) (discussing situation in which debtor transferred property subject to judicial lien to his brother who then reconveyed it back to debtor subject to lien prior to filing of bankruptcy); *In re Scott*, 12 Bankr. 613, 618 (Bankr. W.D. Okla. 1981) (discussing case where property was simultaneously conveyed to debtor subject to security interest and not judicial lien as result of divorce decree).

278. Two of the cases involved schemes to avoid the effects of divorce decrees. In each of those cases the decree provided that one spouse kept the family residence, while the other spouse retained a lien to secure future payments due under the decree. *Farrey v. Sanderfoot*, 1991 WL 83070, 2 (U.S.); *In re Scott*, 12 Bankr. at 614. One case involved a fraudulent scheme to avoid the lien. *In re Stephens*, 15 Bankr. at 486. The remaining case involved a scheme to avoid an existing judgment lien on property jointly owned by transferring property in fee to one of the judgment debtors. *In re McCormick*, 18 Bankr. at 912. In each of the four cases there is clearly an attempt by the debtor to treat creditors in a manner that is inconsistent with the fair dealing covenant, which is one strand of the moral fiber underlying the system of debtor financial relief. Such action on the part of a debtor justifies the decision not to permit avoidance of the lien.

awareness that a debtor must be accountable for his failure to do commutative justice to his creditors.

The breach of the implied covenant of fair dealing is not in the *Owen* case. In *Owen* the debtor undertook no scheme to avoid the lien. Under the moral justification for the financial rehabilitation of the debtor, society's humanitarian response to the debtor in the granting of exemptions is mutually dependent upon the fair dealing on the part of the debtor with his creditors. Thus, in deciding the *Owen* case, the appellate court should not blindly follow precedent, but should undertake to determine whether permitting avoidance will advance the underlying values inherent in the moral justification for debtor financial relief. In doing so the appellate court should adopt the humanitarian resolution to this case and permit lien avoidance. Such a decision promotes the mutually dependent strands of values that underlie the moral justification for debtor financial relief.

