DISCHARGEABILITY OF DEBTS

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by

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I. BAPCPA Changes to Section 523

When the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") became law, most of the attention of the public and even attorneys was focused on the provisions affecting abuse issues and counseling issues. Now that judges and practitioners have had a year to work with the changes, other issues, like dischargeability concerns, may receive more attention. To date there have been few dischargeability cases decided under BAPCPA in cases where the law change made a difference.

11 U.S.C. § 523(a)(1)(B) now provides that a debtor is not discharged from a tax debt "with respect to which a return, *or equivalent report or notice,* if required . . . was not filed *or given* [or] was filed *or given* after the date on which such return, *report, or notice* was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition . . . . " The addition of the new language appears to have been motivated by a desire to clarify that state, and not solely federal, laws regarding tax returns are relevant under this section. This intention is evidenced by the addition of a "hanging paragraph" at the end of Section 523(a)(19), which provides that "the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law . . . . " *See also* 106 H. Rpt. 123 ("It would also be helpful to clarify that the term 'equivalent report or notice' applies only to the extent that state or local tax law provides for the filing of an equivalent report or notice, and has no application for federal income tax reporting purposes."). This intent is also evidenced with BAPCPA's addition of 11 U.S.C. § 523(a)(14A), which provides that a debtor is not discharged from a debt "incurred to

pay a tax to a governmental unit, other than the United States, that would be nondischargeable under paragraph (1)" of Section 523.

11 U.S.C. § 523(a)(2)(C)(i)(I) now provides that a presumption of nondischargeability arises in regard to "consumer debts owed to a single creditor and aggregating more than *$500* for luxury goods or services incurred by an individual debtor on or within *90* days before the order for relief under this title . . . ." The pre-BAPCPA version of the same section provided that the presumption arose if the consumer debts were incurred on or within 60 days before the order for relief and totaled more than $1,225. Section 523(a)(2)(C)(i)(II) provides that a presumption of nondischargeability arises in regard to "cash advances aggregating more than *$750* that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within *70* days before the order for relief under this title . . . ." The pre-BAPCPCA version of the same section provided that the presumption arose if the cash advances were incurred on or within 60 days before the order for relief and totaled more than $1,225. The decrease in the dollar amount and subsequent increase in the time limitations appears to have been motivated by Congress's perception that consumer debtors were abusing the bankruptcy system by intentionally incurring debt while knowing that they would soon file for bankruptcy:

> Unnecessary bankruptcy filings continue to increase at dramatic rates. Often, individuals go on spending sprees for luxury goods and services just before filing for bankruptcy, knowing that they can wipe the slate clean and avoid paying for what they bought.
>
> This is bad for consumers and bad for the economy. When individuals avoid their debts when they could be paid off, the costs are passed on to America's businesses and consumers. We must ensure that debtors actually belong in bankruptcy and are not using the system to avoid their obligations.
>
> This bill stops abuse by eliminating incentives in the current bankruptcy system that actually encourage consumer bankruptcy filings and abuse. It requires those who can repay their debts to do so. It also gives courts greater power to dismiss frivolous or abusive bankruptcy filings and punish lawyers who encourage these filings.

151 Cong. Rec. H. 1993.

11 U.S.C. § 523 (a)(5) now provides that a debtor is not discharged from a debt constituting a "domestic support obligation." That term is defined in section 101(14A). This exception from discharge is essentially confined in the same manner as it was pre-BAPCPA; the only difference is that this exception now expressly mentions that it applies to a debt that accrues "before, on, or after the date of the order for relief", 11 U.S.C. § 101(14A), whereas pre-BAPCA, such a clarification was absent.

11 U.S.C. § 523(a)(8) provides that a debtor is not discharged for certain student loan debts. The only difference created by BAPCPA is the addition of excepting from discharge "any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual . . . . " 11 U.S.C. § 523(a)(8)(B). This addition adds loans from additional lenders as possible nondischargeable loans; e.g. loans from nonprofit entities who issue "GOAL notes." These are loans made pursuant to the Great Opportunities Academic Loan Program. See *Micko v. Student Loan Finance Corp. (In re Micko)*, 2006 WL 3525042 (Bankr. D. Ariz. 2006).

11 U.S.C. § 523(a)(9) now clarifies that a debtor is not discharged from a debt dealing with the "death or personal injury caused by the debtor's operation of a motor vehicle, *vessel, or aircraft* if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance . . . . " Although nothing was readily available in the legislative history regarding this revision of the Bankruptcy Code, it appears that Congress may have included the terms "vessel" and "aircraft" to clarify the scope of this exception since numerous cases dealt with cases concerning what fit under the term "motor vehicle." *See, e.g., Boyce v. Greenway (In re Greenway)*, 71 F.3d 1177, 1180 (5th Cir. 1996) (finding that a boat is not a "motor vehicle" under Section 523(a)(9)); *Willison v. Race*, 192 B.R. 949, 954 (W.D. Mo. 1995) (finding that a motorboat is a "motor vehicle" under Section 523(a)(9)).

II. Differences Between Chapters 7, 11, 12 and 13 Debt Dischargeability

All of the exceptions to discharge can be found in 11 U.S.C. § 523. The provisions of section 523 only apply to debtors who are persons and not business entities because corporations and partnerships do not receive discharges. Steven H. Felderstein et al., *Commencing A Voluntary Chapter 7 or Chapter 11 Case*, 890 PLI/Comm. 131, 143 (2006). All of the exceptions are applicable to cases under chapters 7, 11, and 12. See § § 727 (b), 1141(d)(2) and § 1228(a). If a party in interest proves that one of these exceptions applies, then the particular debt to which the exception applies will not be discharged. Some of these common exceptions include, generally:

> (1) certain taxes or custom duties [§ 523(a)(1)];
>
> (2) debts for "money, property, services, or an extension, renewal, or refinancing of credit" that are either obtained by (a) "false pretenses, a false representation, or actual fraud" or (b) "use of a statement in writing . . . that is materially false . . . respecting the debtor's or an insider's financial condition . . . on which the creditor . . . reasonably relied [and] that the debtor caused to be made or published with intent to deceive . . . . " [§ 523(a)(2)];
>
> (3) debts for luxury goods totaling more than $500 and purchased on or within 90 days prior to filing for bankruptcy and cash advances totaling more than $750 and obtained on or within 70 days prior to filing for bankruptcy [§ 523(a)(2)(C)(i)];
>
> (4) certain claims that the debtor failed to list or schedule [§ 523(a)(3)];
>
> (5) debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . . " [§ 523(a)(4)];
>
> (6) debts "for a domestic support obligation" [§ 523(a)(5)] and other divorce-related debts [§ 523(a)(15)];
>
> (7) debts "for willful and malicious injury by the debtor to another entity or to the property of another entity" [§ 523(a)(6)];
>
> (8) student loan debts unless they constitute an "undue hardship" [§ 523(a)(8)];

(9) debts “for death or personal injury caused by the debtor’s operation of a motor vehicle, vessel, or aircraft if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance” [§ 523(a)(9)];

(10) anything that could have been listed or scheduled in a prior bankruptcy in which the debtor either waived discharge or was denied a discharge [§ 523(a)(10)];

(11) debts provided in a final judgment or order issued by the judiciary or certain other governmental agencies concerning “any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union” [§ 523(a)(11)];

(12) debts “for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution . . . . ” [§ 523(a)(12)];

(13) debts “for any payment of an order of restitution issued under title 18, United States Code” [§ 523(a)(13)];

(14) any debts owed as tax claims or any fines or penalties imposed under Federal election law [§ 523(a)(14), (14A), & (14B)];

(15) fees owed after the order for relief that are payable to a “membership association with respect to the debtor’s interest in a unit that has condominium ownership, in a share of a cooperative, corporation, or a lot in a homeowners association . . . . ” [§ 523(a)(16)];

(16) debts “for a fee imposed on a prisoner by any court for the filing of a case, motion, complaint, appeal, or for other costs and expenses assessed with respect to such filing . . . . ” [§ 523(a)(17)];

(17) monies that are owed to certain pension, profit-sharing, stock bonus, or other financial plans [§ 523(a)(18)]; and

(18) debts that are owed as a result of a violation of any federal or state securities laws or “common law fraud, deceit, or manipulation on connection with the purchase or sale of any security . . . . ” [§ 523(a)(19)].

A chapter 13 discharge is different than the discharge received in any other chapter. Pre-BAPCPA, the chapter 13 discharge was often called the “superdischarge” because debtors could discharge debts that might otherwise be nondischargeable under 523(a)(1), (a)(2), (a)(3), (a)(4), (a)(6), (a)(15), (a)(16), (a)(17), (a)(18), and (a)(19). This superdischarge incentivized some debtors to file chapter 13 cases to discharge numerous debts. BAPCPA changed the Bankruptcy Code however by cutting the number of sections of 523 which chapter 13 can override with a discharge. Section 1328(a)(2) provides that a discharge of debts under a chapter 13 plan does not discharge a debtor from debts specified in § 523(a)(1)(B), (1)(C), (2), (3), (4), (5), (8), or (9). It also prevents discharge of any debt “for restitution, or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of any individual.” 11 U.S.C.§ 1328(a)(4). It also excepts from the future discharge debts which are section 507(a)(8)(C) claims. These are unsecured governmental claims for taxes “required to be collected or withheld and for which the debtor is liable in whatever capacity.” These taxes are the so-called trust fund taxes for which a debtor might be a responsible person.

III. Dischargeability of Credit Card Debt

Credit card companies seek to prevent the dischargeability of credit card debts through the utilization of 11 U.S.C. § 523(a)(2)(A), which provides that a debtor may not receive a discharge “for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud.” Proof of the elements necessary to a § 523(a)(2)(A) case is difficult in the credit card context because the credit card issuer/user relationship is unlike most contract situations faced by attorneys and courts. Issuers and users do not meet face to face; use of the card is accomplished over a period of time, usually in multiple transactions; credit information obtained from potential card holders is sometimes nonexistent and, at other times, is sparse; credit card companies do not update the information. These factors have resulted in very disjointed, noncohesive case law in the area. Professor Margaret Howard wrote an article explaining the inconsistent state of the law.

Margaret Howard, *Shifting Risk and Fixing Blame: The Vexing Problem of Credit Card Obligations in Bankruptcy,* 75 Am. Bankr. L.J. 63 (2001) (hereafter, Howard Article).

There are several problems raised by § 523(a)(2)(A). First, is there any difference among the three stated types of actionable activities by debtors--false pretenses, false representations and actual fraud? The Bankruptcy Act of 1898 only contained the terms "false pretenses" and "false representations." The Bankruptcy Code of 1978 added the term "actual fraud." The legislative history to the new Code stated that "[s]ubparagraph (A) is intended to codify current case law, e.g., *Neal v. Clark*, 95 U.S. 704 . . . (1877) which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law." 124 CONG. REC. H11,096 (daily ed. Sept. 28, 1978, S17412 (daily ed. October 6, 1978) (remarks of Rep. Edwards and Sen. DeConcini). Most courts have viewed this history to mean no more than that fraud cannot be imputed. Howard Article, *supra*. at 76. Some courts have however read this history to mean that actual fraud was added as a ground under a common law test, but false pretenses and false representations are different "offenses" not subject to proof of the elements of common law fraud. Howard Article, *supra*. at 77-78.

The cases define "false pretenses" as "an implied misrepresentation or conduct intended to create or foster a false impression." *FCC Nat'l Bank v. Etto (In re Etto)*, 210 B.R. 734, 739 (Bankr. N.D. Ohio 1997). "False representations" are "an expressed misrepresentation by a debtor." *Id.* The *Etto* court contrasts these with actual fraud which it states "include[s] a 'deception intentionally practiced to induce another to part with property or to surrender some legal right, and which accomplishes the end designed.'" *Id*. *See also F.C.C. Nat'l Bank v. Reid (In re Reid),* 237 B.R. 577 (Bankr. W.D.N.Y. 1999) and *Citibank F.S.B. (Florida) v. Cox (In re Cox),* 150 B.R. 807 (Bankr. N.D. Fla. 1992).

The common law fraud elements of actual fraud (and false pretenses and false representations as well, if one subscribes to the view that the three are the same) come from the RESTATEMENT (SECOND) OF TORTS and Prosser's treatise on torts. These elements were discussed in *Field v. Mans,* 516 U.S. 59 (1995), the U.S. Supreme Court's case dealing with a §

523(a)(2)(A) dischargeability issue. The Field case dealt only with the fraud element of reliance by the creditor. The Supreme Court did define reliance based on the common law fraud test in the Restatement. *Id.* at p. 70. The five elements of the test are stated below.

To prove actual fraud under Section 523(a)(2)(A), the creditor has the burden to prove, by a preponderance of the evidence, "(1) that the debtor made the representations; (2) that at the time he knew they were false; (3) that he made them with the intention and purpose of deceiving the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained alleged loss and damages as the proximate result of such representations." *Diamond v. Kolcum (In re Diamond)*, 285 F.3d 822, 827 (9th Cir. 2002) *quoting Household Credit Servs. v. Ettell (In re Ettell)*, 188 F.3d 1141, 1144 (9th Cir. 1999). *See also AT&T Universal Card Servs. v. Mercer (In re Mercer)*, 246 F.3d 391, 403 (5th Cir. 2001). Since, in a credit card transaction, the third-party seller, and not the creditor, is the party involved in the immediate transaction, it is difficult for a creditor to prove that it relied on the debtor's representations. Therefore, courts have adopted three approaches to deal with the creditor's reliance on a debtor's alleged misrepresentations.

One approach has been termed "implied representation." Under this approach, the presumption is that when a debtor utilizes his or her credit card in a transaction, an implied representation is being made that he or she has the ability and/or intention to pay the debt incurred. *Citicorp Nat'l Credit & Mortgage Servs. v. Welch (In re Welch)*, 208 B.R. 107, 110 (S.D.N.Y. 1997). If the creditor proves that the debtor incurred the debt knowing either that they did not have the ability to pay or did not have the intention to repay, then the creditor will have sustained its burden of proving reliance and damages. *Id.*

A second approach is deemed "assumption of the risk." Under this approach, "a credit card user will only be found to have intentionally made a false representation when three conditions are met: (1) the credit card has been revoked; (2) revocation of the card has been communicated to the card holder; and (3) the card holder continues to use the card." *Universal Bank v. Stephens (In re Stephens)*, 302 B.R. 218, 224 n.1 (Bankr. N.D. Ohio 2003) *citing First*

Nat'l Bank v. Roddenberry, 701 F.2d 927, 932-33 (11th Cir. 1983). The charges incurred by the debtor after the creditor's communication of revocation constitute the false representation and are therefore nondischargeable under Section 523(a)(2)(A). *AT&T Universal Card Servs, Inc. v. Nguyen (In re Nguyen)*, 235 B.R. 76, 84 (Bankr. N.D. Cal. 1999).

The third approach that has garnered attention is usually referred to as "totality of the circumstances." Under this approach, the court weighs twelve non-exclusive factors in determining whether the debtor has made a false representation. *Chevy Chase Bank FSB v. Kukuk (In re Kukuk)*, 225 B.R. 778, 786 (B.A.P. 10th Cir. 1998). These twelve factors are:

> (1) the length of time between the charges made and the filing of bankruptcy;
>
> (2) whether the debtor consulted an attorney regarding bankruptcy prior to the charges being made;
>
> (3) the number of charges made;
>
> (4) the amount of the charges;
>
> (5) the financial condition of the debtor at the time the charges were made;
>
> (6) whether the charges were above the credit limit of the account;
>
> (7) whether the debtor made multiple charges on any given day;
>
> (8) whether or not the debtor was employed;
>
> (9) the debtor's employment prospects;
>
> (10) the debtor's financial sophistication;
>
> (11) whether there was a sudden change in the debtor's buying habits; and
>
> (12) whether the purchases were made for luxuries or necessities.

Id.

The case law and theories used by courts to determine whether a credit card issuer has proven its case for nondischargeability under § 523(a)(2)(A) do not clearly follow the common law fraud elements. The implied representation theory implies fraud if a debtor uses her card and cannot pay. The debtor has no ability to prove her own subjective intent to pay. The common law requires subjective proof of intent as an element. The assumption of risk theory holds that a creditor always will be held to not have justifiably relied unless a debtor has exceeded her card limits. This premise guts the justifiable reliance prong of the common law test. The totality of the circumstances test uses an objective test of a debtor's intent to repay. The common law standard requires a subjective test.

For a discussion arguing against interpreting "actual fraud" by using common law principles of fraud, read Larry Bates, *Excepting Credit Card Debt From Discharge In Bankruptcy: Why Fraud Can't Mean What The Courts Want It To Mean*, 78 N.D. L. Rev. 23 (2002).

In a recent decision by Judge Sidney Brooks, proposed stipulated settlements between credit card companies and debtors were not approved by the judge without a further hearing. *MBNA America Bank, N.A. v. Panem (In re Panem)*, 352 B.R. 269 (Bankr. D. Colo. 2006). The debtors settled their cases, according to the stipulations, because they could not afford the litigation costs, not because they agreed they had engaged in any fraudulent activity.

> The complexity and expense analysis is a bit of a quandary for the Court; that is, does the Court approve the Stipulations realizing that going forward in the litigation can be quite expensive, personally demanding, inconvenient and problematic for the Defendants? Or, does this Court approve the Stipulations despite the stacking of the legal and financial cards in favor of MBNA and Discover? The Court believes it cannot approve the Stipulations because of this dilemma and because it does not have sufficient information before it so as to determine that the Stipulations are fair and equitable.

Id. at 287.

The passage of BAPCPA made it easier for creditors to object to a discharge of credit card obligations by reducing the money and time limits needed to create a presumption of nondischargeability. Pre-BAPCPA, a presumption of nondischargeability was raised if the debtor owed consumer debts to a single creditor that was more than $1,225 "for luxury goods or services incurred . . . on or within 60 days before the order for relief . . . ." Post-BAPCPA, the presumption is now raised if the debtor incurs a $500 liability on or within 90 days before the order for relief. Pre-BAPCPA, a presumption of nondischargeability was raised for "cash advances aggregating more than $1,225 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief . . . . " Post BAPCPA, the presumption is now raised if the debtor incurs $750 in such debt acquired on or within 70 days before the order for relief.

IV. Dischargeability of Student Loans

11 U.S.C. § 523(a)(8) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt–
>
> (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for–
>
> (A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution . . . .

The most widely used test for determining what constitutes an "undue hardship" was developed by the Second Circuit in *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987). The *Brunner* test provides that to prove "undue hardship", the debtor must satisfy a three-part test:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the

> student loans; and (3) that the debtor has made good faith efforts to repay the loans.

Id. at 396. Eight other circuits have adopted the *Brunner* test. *See Educational Credit Mgmt. Corp. v. Frushour (In re Frushour)*, 433 F.3d 393, 400 (4th Cir. 2005); *Oyler v. Educational Credit Mgmt. Corp. (In re Oyler)*, 397 F.3d 382, 385 (6th Cir. 2005); *Educational Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1309 (10th Cir. 2004); *U.S. Dept. of Educ. v. Gerhardt (In re Gerhardt)*, 348 F.3d 89, 91 (5th Cir. 2003); *Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238, 1241 (11th Cir. 2003); *United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1108, 1112 (9th Cir. 1998); *Pennsylvania Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298, 306 (3d Cir. 1995); *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993).

The Eighth Circuit has expressly declined to adopt the *Brunner* test and has instead reaffirmed the "totality of the circumstances" test it articulated in *Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 702, 704 (8th Cir. 1981). *Long v. Educational Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 553 (8th Cir. 2003). The Eighth Circuit declined to adopt the *Brunner* test because it believed that the "totality of the circumstances" test provides "a less restrictive approach to the 'undue hardship' inquiry." *Id*. at 554.

> . . . . We are convinced that requiring our bankruptcy courts to adhere to the strict parameters of a particular test would diminish the inherent discretion contained in § 523(a)(8)(B). Therefore, we continue-as we first did in *Andrews*-to embrace a totality-of-the-circumstances approach to the "undue hardship" inquiry. We believe that fairness and equity require each undue hardship case to be examined on the unique facts and circumstances that surround the particular bankruptcy.
>
> In evaluating the totality-of-the-circumstances, our bankruptcy reviewing courts should consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case. Simply put, if the debtors' reasonable future financial resources will sufficiently cover

> payment of the student loan debt-while still allowing for a minimal standard of living-then the debt should not be discharged.

Id. at 554-555.

A search of Section 523(a)(8) in the Lexis and Westlaw databases only produced four cases dealing with the subject in the D.C. Circuit, none of which directly dealt with the issue of which test controlled. The First Circuit Court of Appeals, on the other hand, has not expressly adopted either test. *See Nash v. Connecticut Student Loan Found. (In re Nash)*, 446 F.3d 188 (1st Cir. 2006). However, some lower courts in the First Circuit have adopted either the *Brunner* test or the "totality of the circumstances" test. *See, e.g., Hicks v. Educational Credit Mgmt. Corp. (In re Hicks)*, 331 B.R. 18, 32 (Bankr. D. Mass. 2005) (adopting the "totality of the circumstances" test); *Garrett v. New Hampshire Higher Educ. Assistance Found. (In re Garrett)*, 180 B.R. 358, 362 (Bankr. D.N.H. 1995) (adopting the *Brunner* test).

Two other tests regarding what constitutes an "undue hardship" were developed in the Eastern District of Pennsylvania and have been discussed in two recent law review articles. *See* Edward Paul Canterbury, *The Discharge Of Student Loans In Bankruptcy: A Debtor's Guide To Obtaining Relief*, 32 Ohio N.U. L. Rev. 149, 155-58 & 161-62 (2006); Sarah Edstrom Smith, *Should The Eighth Circuit Continue To Be The Loan Ranger? A Look At The Totality Of The Circumstances Test For Discharging Student Loans Under The Undue Hardship Exception In Bankruptcy*, 29 Hamline L. Rev. 602, 616-18 (2006). The first test developed by the Eastern District of Pennsylvania has been referred to as the *Johnson* test and the second test has been referred to as the *Bryant* test. *See id*. However, considering the fact that the Eastern District of Pennsylvania is in the Third Circuit, the Third Circuit expressly adopted the *Brunner* test in *Pennsylvania Higher Educ. Assistance Agency v. Faish (In re Faish)*, 72 F.3d 298, 306 (3d Cir. 1995), and the rest of the circuits either utilize the *Brunner* test or the "totality of the circumstances" test, it would appear that the *Johnson* and *Bryant* tests are merely useful in law review discussions since they do not have any efficacy in the real-world practice of bankruptcy law.

A new issue that has arisen in recent case law regarding the dischargeability of student loans is whether a debtor may receive a discharge when he or she fails to utilize the government's William D. Ford Income Contingent Repayment Plan ("ICRP"). The ICRP program is succinctly summarized as follows:

> The [ICRP] permits a student loan debtor to pay twenty percent of the difference between his adjusted gross income and the poverty level for his family size, or the amount the debtor would pay if the debt were repaid in twelve years, whichever is less. Under the program, the borrower's monthly repayment amount is adjusted each year to reflect any changes in these factors. The borrower's repayments may also be adjusted during the year based on special circumstances. *See* 34 C.F.R. § 685.209(c)(3). At the end of the twenty five year payment period, any remaining loan balance would be cancelled by the Secretary of Education.

Korhonen v. Educational Credit Mgmt. Corp. (In re Korhonen), 296 B.R. 492, 496 (Bankr. D. Minn. 2003). *See also* 34 C.F.R. § 685.209.

A debtor's participation or non-participation in an administrative repayment program, such as the ICRP, is at least a factor in determining whether a debtor's student loans should be discharged. *See Bacote v. Educational Credit Management Corp. (In re Bacote)*, 2006 WL 3732993 (Bankr. S.D.N.Y. 2006); *Brosnan v. American Educ. Servs. (In re Brosnan)*, 323 B.R. 533, 538 (Bankr. M.D. Fla. 2005) *quoting United States Dept. of Educ. v. Wallace (In re Wallace)*, 259 B.R. 170, 185 (C.D. Cal. 2000) ("A factor the Court must consider when determining whether Plaintiff exhibited good faith when seeking discharge of her student loans is her 'effort – or lack thereof – to negotiate a repayment plan.'"); *Rutherford v. William D. Ford Loan Program (In re Rutherford)*, 317 B.R. 865, 881 (Bankr. N.D. Ala. 2004) ("The ICRP is one factor to consider in deciding the dischargeability of student loans."); *Nanton-Marie v. United States Dept. of Educ. (In re Nanton-Marie)*, 303 B.R. 228, 236 (Bankr. S.D. Fla. 2003) *quoting In re Korhonen*, 296 B.R. at 496 ("[P]articipation, or non-participation as the case may be, 'is but one factor to be considered in determining undue hardship '"). Defendants in these cases have argued for a ruling that failure to pursue such administrative remedies prior to seeking bankruptcy relief should lead to an automatic denial of discharge. *See In re Brosnan,* 323 B.R. at 538-39 (denying discharge of student loans because plaintiff "did not seek a loan discharge due to total and permanent disability" nor attempt "to negotiate her payment schedule"). However, some cases posit that "there is no section of the Bankruptcy Code that requires it as a condition precedent to an undue hardship discharge." *In re Nanton-Marie*, 303 B.R. at 235. Instead, it "'is but one factor to be considered in determining undue hardship[;] it is not determinative.'" *Id*. at 236 *quoting In re Korhonen*, 296 B.R. at 496.

Some cases, however, appear to agree that the government has a right to require the exhaustion of its administrative remedies before a debtor may properly seek discharge of his or her student loans. In *Vermaas v. Student Loans of North Dakota (In re Vermaas)*, 302 B.R. 650 (Bankr. D. Neb. 2003), a married couple sought to discharge their individual student loan debts. *Id. at* 653-54. The debtor-husband suffered from physical and mental problems that left him "a non-functioning individual relying upon his wife for support. " *Id*. at 655. He was not found "to be totally disabled by the Social Security Administration. " *Id*. Nonetheless, the debtor-husband still obtained his degree with the help of the student loans in question. *Id*. At the time of this bankruptcy proceeding, the debtor-husband never made a payment, did not seek to participate in the ICRP program, and didn't seek an administrative discharge upon a finding of total and permanent disability. *Id*. The court denied the debtor-husband's discharge based on the following reasoning:

> [T]he fact that he was physically, mentally, and emotionally capable of obtaining an associate of arts degree is an indication that he is able to fill out the appropriate forms to give the student loan program the opportunity to review and analyze his situation under the appropriate regulations. His failure to take such action is a relevant fact and circumstance that this court must consider and that this court has considered. Although it does appear that he has no current income and very little likelihood of future income, the Bankruptcy Code student loan hardship discharge should not be granted unless the student loan debtor has exhausted his administrative remedies under the student loan program. Even though it is unlikely that the program can ever obtain payments

> from [the debtor-husband] because he has no income and no assets, the program administrators have the right to the opportunity to evaluate his financial circumstances and apply their regulatory procedures. Unless a debtor provides the program with sufficient information to apply its administrative procedures, there is no legal or factual basis for granting a hardship discharge under the Bankruptcy Code.

Id. at 660.

Other courts reason that although a debtor that participates in the ICRP may never have to make a payment under the program, a debtor may nonetheless have to pay taxes on the loan that is discharged 25 years later. *See Educ. Credit Management Corp. v. Barrett (In re Barrett),* 337 B.R. 896 (6th Cir. B.A.P. 2006); *Coatney v. United States Dept. of Educ. (In re Coatney)*, 345 B.R. 905, 910-11 (Bankr. C.D. Ill. 2006) (discussing its concern "that the Debtor could face a huge tax liability for imputed income [after] the termination of his ICRP payment period"); *Allen v. American Educ. Servs. (In re Allen)*, 324 B.R. 278, 281-82 (Bankr. W.D. Pa. 2005) ("[I]t is not necessarily the case that each and every debtor will benefit from . . . the [ICRP] – indeed, some debtors would most likely suffer were they to take advantage of the [ICRP. A] debtor, by entering into a repayment plan under the [ICRP], may potentially incur, after the 25-year repayment term called for under the [ICRP], a substantial, ultimately nondischargeable, tax obligation as a result of the discharge of that portion of his or her student loan debt that ultimately is not repaid under such repayment plan."); *Williams v. Educational Credit Mgmt. Corp. (In re Williams)*, 301 B.R. 62, 79 (Bankr. N.D. Cal. 2003) ("Twenty-five years from now, . . . forgiveness of any balances that were not paid under the Ford Program [may] constitute taxable income.").

For a complete discussion on the cases dealing with the ICRP and the dischargeability of student loan debts under 11 U.S.C. § 523(a)(8), read Terrence L. Michael & Janie M. Phelps, *"Judges?!–We Don't Need No Stinking Judges!!!": The Discharge Of Student Loans In Bankruptcy Cases And The Income Contingent Repayment Plan*, 38 Tex. Tech L. Rev. 73 (2005).

In a decision in which a court denied discharge of a student loan because the debtor could pay something on her student loan under the ICRP standards, the court did leave open the possibility of the debtor later seeking to discharge the debt if her circumstances changed. *Brunell v. Citibank (South Dakota) N.A., et al. (In re Brunell)*, 2006 WL 3581498 (Bankr. D. Mass. 2006). The Brunell court relied on earlier cases that held that a decision as to the nondischargeability of a student loan at one time is not res judicata as to a request at a later date. *Nash v. Conn. Student Loan Foundation et al. (In re Nash)*, 446 F.3d 188 (1st Cir. 2004); *Storey v. Nat'l Enter. Sys. (In re Storey)*, 312 B.R. 867 (Bankr. N.D. Ohio 2004).

In another interesting case decided in 2006, a debtor sought to discharge her student loan pursuant to § 523(a)(8). However, she filed her chapter 7 case on August 9, 1999 and was discharged on December 6, 1999. On March 14, 2000, the debtor consolidated her three prebankruptcy student loans with a loan from Sallie Mae. Therefore, when the debtor sought to discharge the loan by suing Sallie Mae, Sallie Mae moved to dismiss the case. It asserted that its debt was a postpetition debt and not dischargeable in the 1999 bankruptcy case. The Ninth Circuit BAP agreed and dismissed the case. *Educ. Credit Management Corp. v. McBurney (In re McBurney)*, 2006 WL 3848757 (9th Cir. B.A.P. 2006).

V. Dischargeability of Tax Liabilities For Late Returns and After Assessment

11 U.S.C. § 523(a)(1) provides

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt–
>
> (1) for a tax or customs duty–
>
> (A) of the kind and for the periods specified in section 507(a) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
>
> (B) with respect to which a return, *or equivalent report or notice,* if required–
>
> (i) was not filed *or given*; or

> (ii) was filed *or given* after the date on which such return, *report, or notice* was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax . . . .[1]

The majority of cases that have discussed this section deal with the question of what qualifies as a "return." A four-part test has been utilized to determine whether a filing constitutes a "return": "(1) it must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law." *Moroney v. United States of America (In re Moroney)*, 353 F.3d 902, 905 (4th Cir. 2003); *United States of America v. Hatton (In re Hatton)*, 220 F.3d 1057, 1060-61 (9th Cir. 2000); *United States of America v. Hindenlang (In re Hindenlang)*, 164 F.3d 1029, 1033-34 (6th Cir. 1999); *Colsen v. United States of America (In re Colsen)*, 322 B.R. 118, 122 (B.A.P. 8th Cir. 2005).

In *In re Hindenlang*, the debtor failed to file tax returns for the years 1985 through 1988. 164 F.3d at 1031. The IRS completed an assessment of the debtor's tax liability and sent him 30- day and 90-day deficiency letters, none of which led to a response from the debtor. *Id*. Two years after the IRS's assessment, the debtor filed a proper 1040 and "calculated the taxes substantially the same as in the [substitute returns] previously prepared by the IRS", yet still failed to pay any of his liability. *Id*. The court phrased the issue as "whether Forms 1040 filed after the IRS has made an assessment can constitute returns for purposes of § 523(a)(1)(B) . . . . " *Id*. at 1032. The court confronted whether the debtor's filing of the 1040 constituted an "honest and reasonable attempt to satisfy the requirements of the tax law" after finding that the first three parts of the above four-part test had been met. *Id*. at 1034. The court recognized that the IRS

[1] The italicized language constitutes language that was newly added by BAPCPA. To date, no cases have discussed the newly added language. The cases discussed in this paper are pre-BAPCPA cases.

had the burden of proof by a preponderance of the evidence. *Id*. *citing Grogan v. Garner,* 498 U.S. 279, 287 (1991). After laying this procedural framework, the court held that

> as a matter of law[,] a Form 1040 is not a return if it no longer serves any tax purpose or has any effect under the Internal Revenue Code. A purported return filed too late to have any effect at all under the Internal Revenue Code cannot constitute 'an honest and reasonable attempt to satisfy the requirements of the tax law.' Once the government shows that a Form 1040 submitted after an assessment can serve no purpose under the tax law, the government has met its burden.

Id. at 1034.

In *In re Hatton*, the debtor failed to file a tax return for the year 1983. 220 F.3d at 1059. The IRS filed a substitute return on his behalf. *Id*. Subsequently, the IRS sent the debtor a notice of deficiency, to which the debtor failed to respond. *Id*. As a result, the IRS conducted an assessment of the debtor's deficiency and requested payment. *Id*. The debtor failed to pay, but, after being given no other option, entered into an installment agreement with the IRS. *Id*. The court held that neither the substitute return nor the installment agreement constituted a return. *Id*. at 1061. First of all, neither one was signed under penalty of perjury, thereby failing the second part of the above four-part test. *Id*. Secondly, the court determined that neither document constituted "an honest and reasonable attempt to satisfy the requirements of the tax law" since the debtor only entered into the installment agreement only after the IRS threatened to levy his wages and seize his personal property. *Id*. This, in effect, caused him to fail the fourth part of the above test. *Id*.

In *In re Moroney*, the court confronted the issue of "whether delinquent personal income tax filings, submitted years after the Internal Revenue Service has already prepared its own assessments, constitute 'returns' for purposes of the Bankruptcy Code." 352 F.3d 902, 903 (4th Cir. 2003). The debtor failed to file tax returns and the IRS subsequently filed substitute returns for him. *Id*. at 903-04. More than two years later, the debtor submitted income tax statements showing a lesser liability than that shown on the IRS's substitute returns. *Id*. at 904. As a result, the IRS lowered the debtor's assessment. *Id*. The court held that the debtor failed to satisfy the fourth part of the above test since "to belatedly accept responsibility for one's tax liabilities, only when the IRS has left one with no other choice, is hardly how honest and reasonable taxpayers attempt to comply with the tax code." *Id*. at 906. The court refused to accept the debtor's argument that the fourth part of the test had been met since the debtor's subsequent filing transpired into a lower assessment, finding that "[t]he relevant inquiry in whether [the debtor] made an honest and reasonable effort to comply with the tax laws, and not whether [the debtor's] eventual effort had some effect on his tax liability." *Id*.

In *In re Colsen*, the debtor failed to file tax returns, failed to respond to the IRS's notices of deficiency, and filed his 1040 forms after the IRS had filled out substitute returns on his behalf and conducted an assessment of the debtor's liability. 322 B.R. 118, 120 (B.A.P. 8th Cir. 2005). However, the IRS subsequently reduced his tax liability after the debtor filed his 1040 forms. *Id*. The court first determined that a 1040 Form constitutes a return no matter when it is filed, reasoning that "other sections [of the Code] expressly refer to late returns and to the timing of an assessment [thereby showing that when] Congress wanted to make the timing of a return and of assessment relevant for purposes of dischargeability it did so." *Id*. at 122. Moreover, the court discussed the fourth part of the above test, holding that objective intent, rather than subjective intent, determines whether an individual has made an honest and reasonable effort to comply with the tax laws. *Id*. at 126. Objective intent is derived by looking at the documents and determining "if they appear on their faces to constitute endeavors to satisfy the law." *Id*. Applying this test, the court determined that the debtor's 1040 Forms were tax returns since they provided all the required information and even convinced the IRS to lower the debtor's assessment. *Id*.

In *In re Payne*, the court phrased the issue as to "whether a debtor may obtain a discharge in bankruptcy from a tax debt owed to the [IRS] if he failed to file a return until after the IRS assessed the tax that he owed." 431 F.3d 1055, 1056 (7th Cir. 2005). The court focused its discussion on the fourth part of the above test, finding that the first three parts were satisfied. *Id*.

at 1057. In discussing whether the debtor's belated return constituted an honest and reasonable attempt to comply with the tax law, the court held in the negative:

> [T]he belated filing was not a reasonable effort to satisfy the requirements of the tax law, namely, the requirements of filing a timely return and paying the amount of tax calculated on the return. When [the debtor] filed, the IRS had already calculated the tax due from him, which means that he succeeded in defeating the main purpose of the requirement that taxpayers file income-tax returns: to spare the tax authorities the burden of trying to reconstruct a taxpayer's income and income-tax liability without any help from him. A return filed after the authorities have borne that burden does not serve the purpose of the filing requirement.

Id. Despite this seemingly bright-line interpretation of the filing requirements, the court did later clarify its position that a debtor may be able to avoid this result in the future if there were "circumstances beyond a taxpayer's control that prevented him from filing a timely return, or even from asking for an extension of the time to file, before the tax was assessed." *Id*. at 1059-60. However, the court found no such circumstances in this case. *Id*. at 1060.

VI. Dischargeability of Willful and Malicious Injury Debts

11 U.S.C. § 523(a)(6) provides that "[a] discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity. " The party seeking to challenge the dischargeability of a debt has the burden and must prove his or her case by a preponderance of the evidence. *Jett v. Sicroff (In re Sicroff)*, 401 F.3d 1101, 1106 (9th Cir. 2005). "When applying this standard, 'in addition to what a debtor may admit to knowing, the bankruptcy court may consider circumstantial evidence that tends to establish what the debtor must have actually known when taking the injury-producing action.'" *Id. quoting Carrillo v. Su (In re Su)*, 290 F.3d 1140, 1146 (9th Cir. 2002).

In *Kawaauhau v. Geiger,* the Supreme Court dealt with the issue of whether "§ 523(a)(6)'s compass cover[s] acts, done intentionally, that cause injury[,] or only acts done with the actual intent to cause injury[?]" 523 U.S. 57, 61 (1998). The Court reasoned that since "'willful' in (a)(6) modifies the word 'injury,' [then] nondischargeability takes a deliberate or intentional *injury*, [and] not merely a deliberate or intentional *act* that leads to injury." *Id*. Therefore, the Court held that § 523(a)(6) does not apply to "debts arising from recklessly or negligently inflicted injuries. " *Id*.

The scope of the Supreme Court's ruling in *Geiger* has been interpreted by several Courts of Appeals. The first split in interpretation is whether the "willful and malicious injury" requirement is a unitary standard or whether it constitutes two separate factors that need to be independently considered. The Fifth Circuit has held that the test is a unitary one. *See Miller v. J.D. Abrams Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 1998). However, the Eighth and Ninth Circuits consider "willful" and "malicious" separately. *See In re Sicroff*, 401 F.3d at 1105; *Fischer v. Scarborough (In re Scarborough)*, 171 F.3d 638, 641 (8th Cir. 1999).

The other split in reasoning that has occurred is the further clarification of *Geiger*'s standard in regard to what constitutes a "willful and malicious injury." The Fifth Circuit, in applying its unitary standard of interpretation, has held that "an injury is 'willful and malicious' where there is either an objective substantial certainty of harm or a subjective motive to cause harm." *In re Miller*, 156 F.3d at 606. The Bankruptcy Appellate Panel for the Sixth Circuit applies a similar standard. *See Gonzalez v. Moffitt (In re Moffitt)*, 252 B.R. 916, 922 (B.A.P. 6th Cir. 2000) *quoting In re Markowitz,* 190 F.3d 455, 464 (6th Cir. 1999) ("[T]he Sixth Circuit has held that a willful and malicious injury as defined under § 523(a)(6) is one where the debtor 'desires to cause consequences of his act, or . . . believes that the consequences are substantially certain to result from it.'").

On the other hand, the Eighth Circuit, in applying its dual standard, has defined willfulness as "headstrong and knowing conduct" and malicious as "conduct targeted at the creditor . . . at least in the sense that the conduct is certain or almost certain to cause . . . harm." *In re Scarborough*, 171 F.3d at 641 *quoting Johnson v. Miera (In re Miera)*, 926 F.2d 741, 743-44 (8th Cir. 1991) (internal quotations omitted). The Ninth Circuit, which also applies the dual standard of "willful and malicious", defines malicious as "'(1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse.'" *In re Sicroff*, 401 F.3d at 1106 *quoting Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202, 1209 (9th Cir. 2001). *But see In re Miller*, 156 F.3d at 605 (finding that the Supreme Court eliminated the "just cause or excuse" standard in *Geiger*). In that case, the Ninth Circuit went on to say that "it is the wrongful act that must be committed intentionally, rather than the injury itself." *In re Sicroff*, 401 F.3d at 1106. *But see Geiger*, 523 U.S. at 61 ("[N]ondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury."). The court did not discuss the willfulness factor since the debtor conceded that his actions were willful. *In re Sicroff*, 401 F.3d at 1106.

VII. Dischargeability of Divorce Obligations

11 U.S.C. § 523(a)(5) provides that "[a] discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . for a domestic support obligation." A "domestic support obligation" is defined as

> (14A) [A] debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is–
>
> (A) owed to or recoverable by–
>
> (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
>
> (ii) a governmental unit;
>
> (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;
>
> (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title by reason of applicable provisions of–

> (i) a separation agreement, divorce decree, or property settlement agreement;
>
> (ii) an order of a court of record; or
>
> (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
>
> (D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

11 U.S.C. § 101(14A). The portion of the above definition that has confronted the courts the most deals with whether a pre-petition agreement is "in the nature of alimony, maintenance, or support."

"Whether a given debt is in the nature of support is an issue of federal law." *Cummings v. Cummings*, 244 F.3d 1263, 1265 (11th Cir. 2001). Despite being an issue of federal law, "state law does provide guidance in determining whether the obligation should be considered support under § 523(a)(5)." *Id*. *quoting In re Strickland*, 90 F.3d 444, 446 (11th Cir. 1996) (internal quotations omitted). Nonetheless, the court cannot merely accept as determinative the label given to it by the parties or the trial court. *Id*. Instead, the court must "look beyond the label to examine whether the debt actually is in the nature of support or alimony." *Id*. In looking behind the label, the court must determine whether the parties subjectively intended the obligation to function as support or alimony. *Id*. The burden of proving this subjective intention is placed on the party objecting to the dischargeability of the debt, who must meet a preponderance of the evidence standard. *Id*. In carrying out this burden, the objecting party may introduce "'all evidence, direct or circumstantial, which tends to illuminate the parties subjective intent. " *See id*. at 1266. However, it is not enough for the party with the burden to merely show that it was his or her subjective intent that the obligation be in the nature of alimony, maintenance, or support. *See Tilley v. Jessee*, 789 F.2d 1074, 1077-78 (4th Cir. 1986). Instead, the party with the burden must show that it was the subjective intent of both parties involved. *Id*. at 1078.

Although the language under BAPCPA is similar to the language pre-BAPCPA, some changes have been effectuated. For instance, pre-BAPCPA, a spouse seeking to have the debtor's marital debt deemed nondischargeable needed to affirmatively file an adversary proceeding; otherwise, the debt would be dischargeable. Randy French, *The Impact Of The New Bankruptcy Law On Divorce, Property Settlements, And The Allocation Of Debt In Divorce*, 49-JAN Advocate (Idaho) 17, 17 (2006). There is no such requirement under BAPCPA, however. *Id*.

Another change brought about under BAPCPA concerns the scope of the exception to discharge for marital debts. Pre-BAPCPA, certain types of marital debts were nondischargeable unless

> (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor, and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or
>
> (B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor . . . .

11 U.S.C. § 523(a)(15)(A)-(B) (pre-BAPCPA). Under BAPCPA, the "ability to pay" and "balance of the harms" tests have been eliminated. Randy French, *The Impact Of The New Bankruptcy Law On Divorce, Property Settlements, And The Allocation Of Debt In Divorce*, 49-JAN Advocate (Idaho) 17, 17 (2006). Therefore, if "the debt otherwise comes within the meaning of § 523(a)(15), it is nondischargeable." *Id*.

For a through discussion on pre-BAPCPA cases dealing with the nondischargeability of marital debts as compared to the changes that have been brought about under BAPCPA, read Daniel A. Austin, *For Debtor Or Worse: Discharge Of Marital Debt Obligations Under The*

Bankruptcy Abuse Prevention And Consumer Protection Act Of 2005 (51 Wayne L. Rev. 1369 (2005).

Two interesting cases from 2006 held that the children of a marriage for whom support is owed have standing to sue to establish the nondischargeability of their support or the ex-spouse may sue. Debtors had challenged the standing of their children as plaintiffs in the suits. *Bell v. Bell (In re Bell)*, 2006 WL 3632237 (Bankr. M.D. Ala. 2006); *Birenbaum v. Birenbaum (In re Birenbaum)*, 2006 WL 2422588 (Bankr. W.D. Pa. 2006).

VIII. Dischargeability and Collateral Estoppel Effect of Prepetition State Court Litigation

There are three distinct principles regarding the preclusive effect that must be given to state court judgments by bankruptcy courts dealing with the issue of whether or not a particular debt is or is not dischargeable. They are (1) collateral estoppel; (2) res judicata, and (3) the Rooker-Feldman doctrine. *See* Christopher V. Hawkins, *The Rooker-Feldman Doctrine And Preclusion In A Nondischargeability Proceeding - Be Careful Where You Draw The Lines*, 28 Cal. Bankr. J. 17 (2005) (providing a discussion of all three principles). *See also* David H. Bathe, *Supreme Court's Views As To Res Judicata Or Collateral Estoppel Effect Of State Court Judgments On Federal Courts*, 72 L. Ed. 2d 911 (2006).

"Collateral estoppel, or issue preclusion, bars relitigation of an issue previously decided in judicial or administrative proceedings if the party against whom the prior decision is asserted had a 'full and fair opportunity' to litigate that issue in an earlier case." *St. Laurent, II v. Ambrose (In re St. Laurent, II)*, 991 F.2d 672, 675 (11th Cir. 1993). Collateral estoppel applies to dischargeability proceedings. *Id*. "If the prior judgment was rendered by a state court, then the collateral estoppel law of that state must be applied to determine the judgment's preclusive effect." *Id*. at 675-76. However, if the prior judgment was rendered by a federal court, then the federal principles of collateral estoppel are applied. *Lady Iris Corp. v. Docteroff (In re Docteroff)*, 133 F.3d 210, 214 (3d Cir. 1997). The federal collateral estoppel law consists of four factors: "(1) the issue sought to be precluded must be the same as the one involved in the prior action; (2) the issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the prior judgment." *Id*.

"The purpose of the collateral estoppel doctrine is to protect parties from multiple lawsuits, prevent the possibility of inconsistent decisions, and conserve judicial resources." *Hill v. Putvin (In re Putvin)*, 332 B.R. 619, 624-25 (B.A.P. 10th Cir. 2005) *citing Montana v. United States*, 440 U.S. 147, 153 (1979). Since collateral estoppel is an affirmative defense, the party asserting its application has the burden of proof. *La Preferida, Inc. v. Cerveceria Modelo, S.A.*, 914 F.2d 900, 906 (7th Cir. 1990). If the reviewing court has any reasonable doubts as to what was actually decided in the trial court, such doubts should be resolved against a finding of preclusion. *Baldwin v. Kilpatrick (In re Baldwin)*, 245 B.R. 131, 134 (B.A.P. 9th Cir. 2000).

One issue that has arisen in case law dealing with collateral estoppel is whether a default or consent judgment may be given preclusive effect in a subsequent proceeding. Generally, the factor in federal collateral estoppel law that has been the subject of the majority of these opinions is whether a default or consent judgment has been "actually litigated." "[C]onsent judgments, while settling the issue definitively between the parties, normally do not support an invocation of collateral estoppel." *Id*. "The rationale behind this general rule is that issues underlying a consent judgment generally are neither actually litigated nor essential to the judgment." *Id*. Similarly, a default judgment will ordinarily "not support the application of collateral estoppel because 'in the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated.'" *Bush v. Balfour Beatty Bahamas, Ltd. (In re Bush)*, 62 F.3d 1319, 1323 (11th Cir. 1995) *quoting* Restatement (Second) of Judgments § 27 cmt. e. (1982).

However, "'[when] it can be said that the parties could reasonably have foreseen the conclusive effect of their actions,' collateral estoppel may apply to issues underlying default or consent judgments." *La Preferida, Inc.*, 914 F.2d at 906. Thus, where a litigant intentionally delayed the proceedings for two years by failing to respond to discovery requests, a default judgment entered against him was given preclusive effect under collateral estoppel principles. *FDIC v. Daily (In re Daily)*, 47 F.3d 365, 367-68 (9th Cir. 1995). The court noted that this was not an "ordinary" default judgment in the sense that the litigant determined that "the burden of litigation outweighed the advantages of opposing" the claim but instead was a case where the party "actively participated in the litigation, albeit obstructively, for two years before judgment was entered against him." *Id*. at 368.

> A party who deliberately precludes resolution of factual issues through normal adjudicative procedures may be bound, in subsequent, related proceedings involving the same parties and issues, by a prior judicial determination reached without completion of the usual process of adjudication. In such a case the "actual litigation" requirement may be satisfied by substantial participation in an adversary contest in which the party is afforded a reasonable opportunity to defend himself on the merits but chooses not to do so.

Id. *See also In re Docteroff*, 133 F.3d at 215 ("We do not hesitate in holding that a party . . . who deliberately prevents resolution of a lawsuit, should be deemed to have actually litigated an issue for purposes of collateral estoppel application."); *In re Bush*, 62 F.3d at 1325 ("Where a party has substantially participated in an action in which he had a full and fair opportunity to defend on the merits, but subsequently chooses not to do so, and even attempts to frustrate the effort to bring the action to judgment, it is not an abuse of discretion for a district court to apply the doctrine of collateral estoppel to prevent further litigation of the issues resolved by the default judgment in the prior action.").

Res judicata, which is also referred to as claim preclusion, is a doctrine whereby "federal courts must give to a state court judgment the same preclusive effect as would be given that judgment under the law of the state in which the judgment was rendered." Christopher V. Hawkins, *The Rooker-Feldman Doctrine And Preclusion In A Nondischargeability Proceeding - Be Careful Where You Draw The Lines*, 28 Cal. Bankr. J. 17, 18 (2005). For instance, if a litigant in a federal court proceeding were to argue that a California state court already ruled on the opposing party's claim, then the federal court would need to apply the res judicata principles of California state law to determine the preclusive effect of that state court's prior judgment. Therefore, the federal court would need to apply the four part California test listed below:

(1) A final judgment on the merits;

(2) Rendered by a court of competent jurisdiction;

(3) A second action involving the same parties; and

(4) The same cause of action involved in both cases.

Id. *quoting Knupfer v. Wolfberg (In re Wolfberg)*, 255 B.R. 879, 882 (B.A.P. 9th Cir. 2000).

The Rooker-Feldman doctrine provides that "the only federal court that may review an issue previously determined by a state court in an action between the parties is the United States Supreme Court." *Jorge v. Mannie (In re Mannie)*, 258 B.R. 440, 444 (Bankr. N.D. Cal. 2001) *citing* 28 U.S.C. § 1257. *See* Jodi F. Manko, *Collateral Estoppel And The Rooker-Feldman Doctrine: The Problematic Effect These Preclusion And Jurisdictional Principles Have On Bankruptcy Law*, 21 Emory Bankr. Dev. J. 579, 595-96 (2005) (providing that the applicability of the Rooker-Feldman doctrine is subject to five exceptions). The *Mannie* court had to determine whether collateral estoppel, res judicata, or the Rooker-Feldman doctrine applied in a proceeding involving the dischargeability of a debt under 11 U.S.C. § 523. *Id*. at 444-45. "In considering the application of these doctrines to an action to except a debt from an individual's discharge pursuant to 11 U.S.C. § 523(a)(2), (4), or (6), it is helpful to consider such an action as comprised by two distinct claims: (1) whether the debtor owes a debt to the plaintiff and (2) whether the debt owed by the debtor to the plaintiff is nondischargeable." *Id*. at 444. The court concluded that all three principles may apply to the first claim of the above test. *Id*. at 444-45.

> However, the res judicata and Rooker-Feldman doctrines may not apply to the second claim: i.e., whether the debt is nondischargeable. Such a claim does not exist until a bankruptcy case is filed. Therefore, the claim cannot have been determined in the pre-petition state court action. In any event, a claim of this sort may only be filed in and determined by the bankruptcy court.
>
> On the other hand, collateral estoppel may apply to issues raised by the claim of nondischargeability and may compel a conclusion that the debt is nondischargeable.

Id. at 445.

The United States Supreme Court has recently clarified the scope of the Rooker-Feldman doctrine. *See Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280 (2005). In that case, Saudi Basic Industries Corporation ("Saudi") filed suit against Exxon Mobil Corporation ("Exxon") in a Delaware state court. *Id*. at 289. Approximately two weeks later, Exxon filed suit against Saudi in the U.S. District Court for the District of New Jersey. *Id*. Approximately two years later, Exxon filed counterclaims against Saudi in the state court suit. *Id*. The counterclaims were the same as the claims asserted by Exxon in the federal suit it filed. *Id*.

In the federal suit filed by Exxon, Saudi filed a motion to dismiss, claiming that it had immunity under the Federal Sovereign Immunities Act of 1976. *Id*. at 289-90. The district court denied Saudi's motion, and Saudi filed an interlocutory appeal with the federal Court of Appeals. *Id*. at 290. Before the Court of Appeals considered the issue, the jury in the state court suit ruled in favor of Saudi. *Id*. When the Court of Appeals heard argument after the state court judgment, it, sua sponte, raised the issue as to whether the Rooker-Feldman doctrine divested it of jurisdiction. *Id*. It held that "[o]nce [Exxon's] claims had been litigated to a judgment in state court, the Court of Appeals held [that the Rooker-Feldman doctrine] 'preclude[d] [the] federal district court from proceeding.'" *Id*. at 290-91. The Supreme Court reversed, finding that '[w]hen there is parallel state and federal litigation, *Rooker-Feldman* is not triggered simply by the entry of judgment in state court." *Id*. at 292. "The *Rooker-Feldman* doctrine . . . is confined to cases . . . brought by state-court losers complaining of injuries caused by state-court judgments rendered before the district court review and rejection of those judgments." *Id*. at 284. "Disposition of the federal action, once the state-court adjudication is complete, would be governed by preclusion law." *Id*. at 293.

For a through discussion on the interplay of preclusion principles in the bankruptcy context, read Christopher Klein, Lawrence Ponoroff, & Sarah Borrey, *Principles Of Preclusion And Estoppel In Bankruptcy Cases*, 79 Am. Bankr. L.J. 839 (2005).