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Fee Shifting in Bankruptcy: Deterring Frivolous, Fraud-Based Objections to Discharge

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FEE SHIFTING IN BANKRUPTCY: DETERRING FRIVOLOUS, FRAUD-BASED OBJECTIONS TO DISCHARGE

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One of the primary purposes of Chapter 7 of the United States Bankruptcy Code is to discharge debtors from most pre-bankruptcy debts and thereby to provide those debtors with a fresh start financially. In this Article, Professor Nathalie D. Martin examines how creditors can abuse one section of Chapter 7 to undermine the fresh start policy. Section 727(a)(4) of the Code denies a general discharge to debtors who make false statements in their bankruptcy petitions. Making a false statement also is a crime that can result in imprisonment. There is, however, no provision in the Bankruptcy Code that sanctions a creditor for alleging without proof that the debtor has made a false statement, even if a court determines that the creditor's objection is meritless. Because most bankruptcy petitions and schedules contain some clerical errors and because debtors rarely can afford to defend against major litigation, a creditor need only threaten a suit or bring a baseless action in order to coerce the debtor into paying an otherwise dischargeable debt. Without a sufficient sanction for filing a frivolous objection to a debtor's general discharge, creditors are essentially free to abuse § 727. In order to deter such abuse, Professor Martin suggests that Congress amend this section of the Bankruptcy Code. Professor Martin's proposed change to § 727 would require that a creditor pay certain fees if it files an objection to discharge but is subsequently unable to produce evidence sufficient to reach a trial on the merits. The proposed amendment also would give courts the discretion to impose sanctions even after trial where such sanctions are warranted. Pending amendment of the Code, this Article recommends that courts use Bankruptcy Rule 9011 to sanction creditor behavior

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that undermines the purposes of the Bankruptcy Code, including frivolous or otherwise improper objections to discharge.

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I. INTRODUCTION

As the gap between the haves and the have-nots continues to widen, more and more situations arise in which to challenge the

American rule with respect to counsel fees.[1] After all, litigation is a rich person's game, and those without liquid assets are frequently unable to defend themselves. This is particularly true when individuals are sued by institutions. Expecting even a well-heeled individual to litigate with institutions is like expecting one to fight rifle fire with bows and arrows.[2] And, as scholars have recognized, repeat offenders in the litigation game can spread their costs over more transactions, and even fight battles that are not cost-effective, in order to make law that is favorable to them and others like them.[3]

Economic power could hardly be more unevenly distributed between the parties than in litigation arising in individual[4] bankruptcy cases, where primarily institutional[5] creditors spar with people already down on their economic luck. As an example of the type of abusive litigation that occurs in bankruptcy, this Article focuses on frivolous objections to a debtor's general bankruptcy discharge.

For most people, bankruptcy is not free.[6] Thus, ironically, many individuals are so broke they cannot afford to file for bankruptcy. In

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1. *See* Marc Galanter, *Why the "Haves" Come out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95, 124-25 (1974).

2. *Cf.* Pisano v. Verdon (*In re* Verdon), 95 B.R. 877, 886 (Bankr. N.D.N.Y. 1989) (noting that creditors often have deep pockets, but consumer debtors are penurious).

3. *See* William J. Woodward, Jr., *"Sale" of Law and Forum and the Widening Gulf Between Consumer and Non-Consumer Contracts in the U.C.C.*, 75 WASH. U. L.Q. 243, 261 (1997).

4. This Article discusses the bankruptcy discharge provided to individuals who file a Chapter 7 bankruptcy petition under § 727 of the Bankruptcy Code. *See* 11 U.S.C. § 727 (1994). Corporations that file Chapter 7 cases do not receive a discharge and thus are not affected by the issues discussed in this Article. Under Chapter 7, corporations and individuals sell all non-exempt assets to satisfy creditors. For a general discussion of Chapter 7, see D. EPSTEIN ET AL., BANKRUPTCY 9-11 (1993). For a comparison of this chapter to other types of bankruptcy, see DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 4-27 (1992).

5. While not all creditors are institutional, many of the most active creditors are. *See In re* United Merchants & Mfrs., Inc., 10 B.R. 312, 313 (S.D.N.Y. 1981) (noting that institutional creditors accounted for a vast majority of the debt in the case), *rev'd*, 674 F.2d 134 (2d Cir. 1982); *In re* Rivers End Apartments, Ltd., 167 B.R. 470, 479 (Bankr. S.D. Ohio 1994) (noting that most secured creditors are institutional creditors). Consequently, the hypotheticals used herein involve institutional rather than individual creditors.

6. For some people, Chapter 7 bankruptcies are free. For example, the Consumer Bankruptcy Assistance Project ("CBAP") in Philadelphia provides free legal assistance, through trained volunteers, to persons who meet certain income guidelines. *See* Susan Block-Lieb, *A Comparison of Pro Bono Representation Programs for Consumer Debtors*, 2 AM. BANKR. INST. L. REV. 37, 47 (1994). Hundreds of Chapter 7 cases have been filed by CBAP in its six years of existence. *See id.* CBAP is considered one of the most successful of its kind. *See id.* at 42-51 (describing the business of CBAP and seven other providers of pro bono bankruptcy services).

fact, many low income people cannot even afford a successful Chapter 7 case,[7] the bankruptcy of choice for people with few assets.[8] The inability to afford bankruptcy results not from the high cost of a debtor's attorney's fees for filing the bankruptcy petition, but from the cost of defending creditor-initiated litigation in these cases,[9] much of which is meritless and filed for leverage purposes only.[10] Debtors with few assets are no match for creditors with unlimited resources,[11] and in a no asset case, in which valuation disputes are uncommon,[12] the biggest threat to a debtor's case is an objection to his bankruptcy discharge.[13]

A creditor can file an objection to discharge at very little cost. The mere filing of such an objection, regardless of its merits, can deny a debtor a general discharge for months, even years,[14] in

7. 11 U.S.C. §§ 701-766.

8. Under 11 U.S.C. § 522, people who file for bankruptcy may exempt, and thus keep, certain assets. *See* 11 U.S.C. § 522. In many states, state law exemptions may be chosen instead of the federal exemptions described in § 522. *See id.* § 522(d) (describing the federal exemptions); *id.* § 522(b)(2)(A) (stating that one may choose the federal exemptions or any others provided by state law). People whose assets do not exceed those that can be retained under the applicable exemptions, and without a salary greatly in excess of their expenses, *see id.* § 707(b), would most certainly file a Chapter 7. Unlike a Chapter 13, such a person may discharge most outstanding debts under § 727 rather than paying off a portion of them under Chapter 13. *See id.* § 1301.

9. Interview with Hon. Gloria M. Burns, United States Bankruptcy Court for the District of New Jersey, in Camden, N.J. (Sept. 23, 1997).

10. In the District of New Jersey, a case involving an objection to discharge that never went to trial cost joint debtors over $15,000. *See id.*

11. *See* Galanter, *supra* note 1, at 99-100.

12. Extensive litigation occurs in valuing a debtors' assets for the purpose of determining which assets are subject to distribution to creditors. Debtors and trustees frequently disagree about the value of certain assets, resulting in extensive valuation hearings. *See* H.R. REP. NO. 95-595, at 227 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6186 (recognizing that valuation hearings were costly and time-consuming).

13. *See, e.g.*, MacLeod v. Arcuri (*In re* Arcuri), 116 B.R. 873, 878 (Bankr. S.D.N.Y. 1990) (noting that no issue is more central to an individual debtor's bankruptcy case than discharge).

14. Once a case is filed, it may take many months, and sometimes even years, to adjudicate, during which time the debtor is in limbo. In one case, the initial valuation hearings took six months and the court took an additional 12 months to render its final decision. *See In re* Jartran, Inc., 44 B.R. 331, 347 (Bankr. N.D. Ill. 1984). Another case in the Eastern District of Pennsylvania was pending for over nine months. Interview with Hon. David A. Scholl, Chief Judge, United States Bankruptcy Court for the Eastern District of Pennsylvania, in Philadelphia, Pa. (Sept. 17, 1997). Moreover, many creditors will lend to a debtor after a bankruptcy, as long as the prior debts are discharged. The debtor is then considered a safe risk because the old debts are gone and the debtor cannot file another bankruptcy for six years. *See* 11 U.S.C. § 727(a)(8) (1994). During the entire time a particular case is pending, however, the debtor is unlikely to be able to obtain credit because the prior debts are not discharged. In the meantime, the debtor is unable to move on to a new psychological chapter in life.

complete derogation of one of the principal purposes of the Bankruptcy Code.[15] The creditor's goal in doing so, however, is not necessarily to deny the debtor's discharge; rather, the goal frequently is to force the debtor to agree to pay her otherwise dischargeable debt to the creditor, a goal that is completely forbidden by the Bankruptcy Code.[16]

Discharge, which relieves a debtor from most pre-petition debts, is the ultimate goal of the individual Chapter 7 case.[17] The discharge is the very foundation of the Bankruptcy Code's "fresh start" policy and is accompanied by a complex system of back-up protections designed to ensure that the fresh start obtained in bankruptcy is real and not illusory.[18]

These mechanisms, however, do not fully protect the individual bankruptcy discharge. Creditor abuses in the objection process

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15. Aptly described as a "cornerstone" of the debtor's economic rehabilitation, *see* Scholtz v. Shapiro (*In re* Shapiro), 59 B.R. 844, 847 (Bankr. E.D.N.Y. 1986), the discharge provisions of the Bankruptcy Code represent the "foremost remedy to effectuate the 'fresh start' which is the goal of bankruptcy relief to the debtor," Ray v. Graham (*In re* Graham), 111 B.R. 801, 805 (Bankr. E.D. Ark. 1990); *see also* Dilworth v. Boothe (*In re* Dilworth), 69 F.2d 621, 624 (5th Cir. 1934) (noting that discharge of debt is "[o]ne of the great objects of the bankruptcy law"); G & G Cards & Gifts, Inc. v. Berman (*In re* Berman), 100 B.R. 640, 644 (Bankr. E.D.N.Y. 1989) ("The granting to a debtor of a 'fresh start' is the quintessence of the bankruptcy code and the litmus against which any argument impacting discharge must be compared in determining compliance with congressional intent."). Through discharge, as the Supreme Court has observed, a debtor gains a " 'new opportunity in life and a clear field in future effort, unhampered by the pressure and discouragement of preexisting debt.' " Lines v. Frederick, 400 U.S. 18, 19 (1970) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244-45 (1934)).

16. *See* 11 U.S.C. §§ 362, 727.

17. *See Local Loan Co.*, 292 U.S. at 244.

18. *See infra* notes 100-14 and accompanying text (describing the various bankruptcy provisions that accompany and complement bankruptcy discharge). Given the importance of the fresh start policy under the Bankruptcy Code, an individual's discharge is to be freely granted, and the exceptions and objections to discharge are to be interpreted narrowly in favor of the debtor and against creditors. Exceptions to discharge under § 523 except certain debts from the debtor's overall discharge, either because of the type of debt (taxes, alimony, or child support), or because of the debtor's wrongdoing (extortion, fraud, etc.). *See* 11 U.S.C. § 523(a). Thus, under § 523, an objection to discharge, if successful, denies discharge of a *particular* debt. *See id.* Under § 727, however, an objection to discharge, if successful, denies a debtor's entire discharge, thus eliminating all the benefits of bankruptcy filing, not just denying the discharge of a particular debt. *See id.* § 727(a). Creditors must produce direct evidence supporting non-dischargeability in order to succeed in denying or limiting discharge. Federal Rule of Bankruptcy Procedure 4005 states that "[a]t the trial on a complaint objecting to a discharge, the [objecting creditor] has the burden of proving the objection." FED. R. BANKR. P. 4005; *see also* Henderson v. Henderson (*In re* Henderson), 200 B.R. 322, 324 (Bankr. N.D. Ohio 1996) (noting that a creditor "bears the burden of establishing that the Debtor's debt to [the creditor] should be excepted from discharge under § 523(a)(5)").

continue to deny debtors their financial fresh start, by coercing debtors to agree to pay back dischargeable debts.[19] Congress anticipated creditor abuses in the area of discharge objections and provided that in certain of these situations, if a creditor brought an unsuccessful objection to discharge, the creditor would be charged with the debtor's attorney's fees.[20] The situations in which Congress chose to allow courts to sanction creditors in this way, however, are few in number and are not those situations most susceptible to creditor abuse.[21]

For example, a creditor may object to the discharge of its own debt only,[22] or to the debtor's entire discharge.[23] Counsel fees are imposed when a creditor unsuccessfully challenges discharge of certain debts.[24] Such fees are not imposed in unsuccessful objections to the debtor's general discharge, however, which pose a far greater threat to the debtor's overall goal.[25] In fact, a creditor can object with no proof whatsoever to a debtor's general discharge on the ground that the debtor made a knowing and fraudulent false oath in his bankruptcy case and not face statutorily imposed fees.[26] These allegations, if true, would constitute bankruptcy fraud and would be punishable by imprisonment and a fine of up to $5000.[27] Yet creditors

19. *See infra* note 36 and accompanying text (discussing potential for abuse by creditors). This conduct is an example of what I have termed "leverage litigation." For a discussion of the potential for abuse when creditors file objections to discharge without considering the grave consequences to the debtor, see *American First Credit Union v. Shaw (In re Shaw)*, 114 B.R. 291, 294 (Bankr. D. Utah 1990).

20. *See* 11 U.S.C. § 523(d); *infra* note 170 and accompanying text (noting that prior to the enactment of § 523(d), bankruptcy courts were not authorized to award fees unless a party acted in bad faith).

21. Such fees are statutorily imposed when a creditor files an unsuccessful objection to the discharge of particular consumer debts under § 523(a), which denies dischargeability because of fraudulent or misrepresentative statements made to a creditor by the debtor pre-petition. *See id.* § 523(d). Fees are not imposed for similar allegations contained in an objection to a debtor's overall discharge. *Compare id.* (authorizing courts to award attorney fees), *with id.* § 727 (providing no authorization for courts to award such fees).

22. *See id.* § 523(a).

23. *See id.* § 727.

24. *See id.* § 523(d).

25. *See id.* § 727; *see also infra* note 127 and accompanying text (comparing § 727 and § 523).

26. *See* 11 U.S.C. § 727 (providing for denial of discharge on various grounds but imposing no sanctions for frivolous objections).

27. *See* 18 U.S.C. § 152(2) (1994). The United States Code provides that "a person who knowingly and fraudulently makes a false oath or account in or in relation to any case under Title 11 . . . shall be fined not more than $5,000, imprisoned not more than 5 years, or both." *Id.* In order to be found guilty of a bankruptcy crime, a separate criminal

are free to allege such crimes, without proof, at no economic risk under existing law.[28] The benefits to a creditor of making even entirely false allegations of bankruptcy fraud far outweigh the risks. With no resources with which to challenge the allegations and a looming, albeit slight, possibility of imprisonment, a debtor is frequently motivated to pay the objecting creditor's debt, even if she has done nothing wrong.

This Article proposes an amendment to the Bankruptcy Code to eliminate inconsistencies within the Code between the sanctions imposed for improper allegations of pre-petition fraud in 11 U.S.C. § 523 and post-petition fraud in 11 U.S.C. § 727. This much needed amendment will punish and deter the most harmful forms of creditor abuse in the area of discharge litigation. Section II of this Article contains a hypothetical example of the type of abuse that occurs in discharge litigation, in order to put the problem in perspective.[29] Section III reviews the history of and policy considerations underlying a debtor's general bankruptcy discharge,[30] and Section IV describes the fresh start scheme supporting the debtor's discharge.[31] Section V compares the various limitations upon discharge contained in the Bankruptcy Code and identifies inconsistencies in the ways in which improper behavior of varying degrees is treated under the Code.[32] Section VI discusses various proposed amendments to the Bankruptcy Code that would impose fees against creditors who improperly object to discharge under § 727(a)(4).[33] This section ultimately proposes that the Bankruptcy Code be amended in two ways: (1) to require the imposition of sanctions in all cases in which the creditor is unable to produce evidence sufficient to reach a trial on the merits; and (2) to permit judges to impose sanctions in cases that do reach trial, when the circumstances justify such a result. Section VII compares the proposed amendment to Bankruptcy Rule 9011, concluding that existing Rule 9011 is insufficient to remedy the problem of abusive credit actions under § 727(a)(4), but that it should

proceeding must be instituted. *See id.* After proving the false oath in a prior proceeding, however, obtaining a conviction in the subsequent criminal proceeding would not be difficult.

28. *Compare* 11 U.S.C. § 523(d) (imposing sanctions for unsuccessful dischargeability actions), *with id.* § 727(a) (imposing no sanctions for unsuccessful objections to discharge).

29. *See infra* notes 36-49 and accompanying text.

30. *See infra* notes 50-99 and accompanying text.

31. *See infra* notes 100-14 and accompanying text.

32. *See infra* notes 115-218 and accompanying text.

33. *See infra* notes 219-39 and accompanying text.

be used, both by debtors' counsel and by courts sua sponte, to address improprieties pending amendment of the Bankruptcy Code.[34] Ultimately, the Article concludes that a failure to impose sanctions in cases involving frivolous objections to discharge effectively denies a discharge to a debtor who cannot afford to pay an attorney to litigate about his or her general discharge, thus depriving the most needy of the very linchpin of bankruptcy benefits.[35]

II. AN EXAMPLE OF AN IMPROPER OBJECTION TO A DEBTOR'S GENERAL DISCHARGE

In order to fully understand the problem addressed in the Article, consider the following example.[36]

Mr. and Mrs. Brown buy a home in San Francisco in 1990 that is affordable on their San Francisco salaries. Then the primary breadwinner loses her job and the couple relocates to Athens, Georgia. The San Francisco home is sold at a $100,000 loss, leaving a California bank with a $100,000 unsecured deficiency claim. The Browns apply for a new loan in Athens in 1994. The mortgage application asks whether there are any judgments against the Browns and, given that the California bank's claim has not been reduced to judgment and there are no other judgments, they respond "no." When asked about the value of their personal property, the Browns are unsure. They are informed by the mortgage broker, who fills out the application and has them sign it, that it is customary to value personal property at 30% of the total amount of the mortgage. Since the mortgage in Athens is $150,000, the personal property is valued at

34. *See infra* notes 240-68 and accompanying text.

35. *See infra* notes 269-71 and accompanying text; *see also* Thomas H. Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393 (1985) (discussing the importance of the bankruptcy discharge in providing a fresh start).

36. This example is based roughly on a case from my own private practice in which the debtors spent over $12,000 to defend against similar creditor complaints, neither of which survived motions for summary judgment. During this time, the creditors made endless attempts to settle the cases. Other attorneys who have represented Chapter 7 debtors have described similar scenarios and, without naming each individual attorney with whom I have spoken, I wish to thank those who took the time to discuss this problem with me. While some courts have witnessed and acknowledged the great leverage that creditors have over debtors in these situations, as well as the corresponding potential for abuse, *see* American First Credit Union v. Shaw (*In re* Shaw), 114 B.R. 291, 294, 297 (Bankr. D. Utah 1990); Chittenden Trust Co. v. Mayo (*In re* Mayo), 94 B.R. 315, 329 (Bankr. D. Vt. 1988); *In re* Burkhardt, 91 B.R. 587, 589 (Bankr. W.D. Okla. 1988), in the vast majority of these situations the courts never see the abuse. The cases are settled without judicial involvement, which makes the problem insidious and hidden from all but the attorneys and clients who experience it firsthand.

$45,000.

When the California bank begins the process of transferring its deficiency claim to Georgia in 1996, the Browns file a bankruptcy petition. The personal property is valued at $10,000 based upon the Browns' lawyer's recommendation that personal property be valued at forced sale prices. After taking a Rule 2004[37] examination of the Browns, the California bank objects to the Browns' general discharge on the basis of a knowing and fraudulent false oath under § 727(a)(4)[38] because: (1) the Browns failed to disclose the Georgia credit application as a financial statement given in the past two years as required by statement of affairs question 17(b);[39] and (2) the Browns undervalued their personal property on their bankruptcy petition, based solely upon the value used in the Georgia credit application.

The California bank, who had served discovery on the Georgia bank, sent the Georgia bank a thank-you note as well as a courtesy

37. FED. R. BANKR. P. 2004. Bankruptcy Rule 2004 provides:

> (a) Examination on Motion. On motion of any party in interest, the court may order the examination of any entity.
>
> (b) Scope of Examination. The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan.
>
> (c) Compelling Attendance and Production of Documentary Evidence. The attendance of an entity for examination and the production of documentary evidence may be compelled in the manner provided in Rule 9016 for the attendance of witnesses at a hearing or trial.

Id.

38. *See* 11 U.S.C. § 727(a)(4) (1994). Under this section, a debtor may be required to pay all of his or her debts, rather than have them discharged, if the debtor knowingly and fraudulently makes a false oath or statement in or in connection with his or her bankruptcy case. *See id.*

39. *See* 2 LAWRENCE P. KING, BANKRUPTCY RULES F-59 (Collier pamphlet ed. 1997). Every debtor must complete and submit to the court a long series of disclosure documents called the "schedules of assets and liabilities" and the "statement of affairs." 11 U.S.C. § 521 (setting forth the debtor's duties). Question 17(b) of the statement of affairs requires a disclosure of "all firms or individuals who within the two years immediately preceding the filing of this bankruptcy case have audited the books of account and records, or prepared a financial statement of the debtor." 2 KING, *supra*, at F-59.

copy of their complaint objecting to the Browns' general discharge. Having been thus far unaware of the California bank's deficiency claim, and facing the deadline, the Georgia bank copies the California bank's complaint and adds an additional ground for denial of discharge under § 727(a)(4),[40] namely that the Browns' general discharge should be denied because the Browns failed to disclose the California claim as a judgment on the Georgia credit application. The Georgia bank's counsel advises against filing an objection to the discharge of its particular debt under § 523(a)(2)(B)[41] because a provision in § 523(d) requires an creditor bringing an unsuccessful suit under this provision to pay the debtor's attorney's fees to defend the action.[42] Instead, counsel advises the bank to file a complaint under § 727. If the complaint turns out to be baseless, the bank may withdraw it later at no cost. Since the debtors face the possibility of imprisonment for a violation of § 727(a)(4),[43] the Georgia bank may be able to get the debtors to agree to a reaffirmation of their whole debt, despite a severe downturn in the market and a partially unsecured claim.

Scenario 1 (The Debtors with Liquid Assets):

After the Browns expend thousands of dollars in attorney fees to conduct discovery, to brief the issues, and to file and argue a summary judgment motion, both creditors' cases are dismissed because, according to the court, it is crystal clear that § 727(a)(4) requires that the alleged false oath occur *in the case*, not two years earlier.[44] Moreover, statement of affairs question 17(b) does not appear to require disclosure of a mortgage application, which is not a

40. *See* 11 U.S.C. § 727(a)(4).

41. *See id.* § 523(a)(2)(B) (providing that the debt of a particular creditor can be excepted from discharge if the debtor obtains the credit through pre-petition fraud).

42. *See id.* § 523(d) (providing that if the creditor brings an action under § 523(a)(2)(B) that is ultimately unsuccessful, the creditor may be required to pay the debtor's attorney's fees in defending the action).

43. *See* 18 U.S.C. § 152 (1994) (providing that making a knowing or fraudulent false oath in or in relation to a bankruptcy case is punishable by a fine of up to $5000 and imprisonment of up to five years).

44. If there is a discrepancy between an asset value provided on the debtor's schedules and the value provided at a previous time, the creditor must prove that the false statement took place in the bankruptcy. *See* Wines v. Wines (*In re* Wines), 997 F.2d 852, 855 (11th Cir. 1993); United States v. Sumpter (*In re* Sumpter), 136 B.R. 690, 700 (Bankr. E.D. Mich. 1991), *aff'd*, 170 B.R. 908 (E.D. Mich. 1994), *rev'd in part on other grounds*, 64 F.2d 663 (6th Cir. 1995), *cert. denied*, 116 S. Ct. 1673 (1996). Prior false statements do not count. The only way to prove that the false statement took place in the case and not prior thereto is to prove that the assets are worth more than the scheduled value. *See infra* note 144 and accompanying text (discussing undervaluation of assets by debtors on schedules).

financial statement.

Scenario 2 (The Debtors without Liquid Assets):

Before the discharge complaints were filed, the Browns had paid their lawyer as much as they could afford. After the discharge complaints were filed, the Browns' lawyer explained that a judgment against them under § 727(a)(4) could actually result in a jail term and that given the stakes and the fact that the creditors were lodging extensive and costly opposition, she needed another $5000 in retainer funds. The debtors did not have it. Fearful of losses of all kinds, they reaffirm the entire Georgia bank debt and agree to pay $50,000 of the $100,000 California bank debt over five years. Although the debtors know they did not intentionally lie or misrepresent anything, they believe they have no choice.

Unfortunately, the hypothetical experiences described above are consistent with reality. As one court noted:

> Filing a nondischargeability action sounding in fraud should never be a routine matter. It requires competent factual and legal analysis by both the plaintiff and its counsel. It would not be undertaken without consideration of the consequences to the debtor, to the creditor, or to the attorney signing the pleading. To use such a filing to "shakedown" an honest debtor who is unable to fund a defense is reprehensible.[45]

Although courts consistently have recognized that denial of a debtor's general discharge is a far more drastic and serious remedy than the mere exception of a particular debt from discharge[46] even if a creditor has no intention of ever proving a thing, bringing a legally untenable complaint under § 727(a)(4) is tolerated under the current statutory scheme.[47]

To make matters worse, in the above scenarios, the lawyers for both creditors either failed to read the statute upon which their complaints were based or saw no risk in bringing meritless suits. Under the first scenario, the frivolous suits cost the two bank clients some money with no return, but at least their lawyers were paid.[48]

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45. American First Credit Union v. Shaw (*In re* Shaw), 114 B.R. 291, 297 (Bankr. D. Utah 1990).

46. *See, e.g.*, Rosen v. Benzer, 996 F.2d 1527, 1531 (3d Cir. 1993); Pyramid Tech. Corp. v. Cook (*In re* Cook), 146 B.R. 934, 935 (Bankr. E.D. Pa. 1992); *In re* Shaw, 114 B.R. at 291; Chittenden Trust Co. v. Mayo (*In re* Mayo), 94 B.R. 315, 329 (Bankr. D. Vt. 1988).

47. *See* § 727(a) (imposing no sanctions for unsuccessful objections to discharge).

48. The bank's lawyer has an obvious conflict of interest. The lawyer is paid regardless of the outcome. The lawyer can always tell her bank client that the discharge

Under the second scenario, the result was far better for the creditors. They were able to use their superior economic position and bargaining power to produce a result that is entirely at odds with the fresh start principles of the Bankruptcy Code. Unfortunately, the fewer liquid assets that a particular debtor owns, the more likely that the second scenario will result, leaving creditors happy and overcompensated and failing to aid the debtor who needs help the most.

While this type of litigation, which I call "leverage litigation," is tacitly tolerated under the current Bankruptcy Code, the Code imposes fees for unsuccessful objections to the discharge of a particular debt.[49] There is no reason for this inconsistency. Given the relative stakes in each type of action, attorney fees should also be statutorily imposed in unsuccessful objections to a debtor's overall discharge.

III. THE HISTORY OF AND POLICIES BEHIND THE GENERAL BANKRUPTCY DISCHARGE

An individual who discloses all information required in his petition, schedules of assets and liabilities, and statement of financial affairs,[50] and who turns over any non-exempt assets to the Chapter 7 trustee so the assets may be sold and the proceeds distributed to creditors,[51] is entitled to a "fresh start"—a chance to start a new financial life without the burden of the pre-filing debts.[52] Obtaining a discharge is the raison d'être of nearly every individual bankruptcy filing, particularly for a debtor with few assets and little income in

was worth fighting as a matter of principle. Furthermore, as Professor Galanter has observed, institutions like banks can use economics of scale in order to achieve long-term gains in litigation. *See* Galanter, *supra* note 1, at 98. Regardless of the results in a particular case, institutions can spread their losses over more cases, and even engage in economically inefficient litigation in order to affect changes in the law. *See id.* at 101.

49. *See* 11 U.S.C. § 523(d) (1994).

50. *See id.* § 521(1).

51. *See id.* § 521(4).

52. *See id.* § 727(a). The primary vehicle through which the "fresh start" is achieved is the discharge granted under § 727(a), which discharges the debtor from all debts that arose prior to the date of the order for relief issued by a bankruptcy court, *see id.*, thus relieving the debtor of all responsibilities to pay back those debts, *see id.* § 727(b). Technically, a discharge is a court order declaring that a person is entitled to immunity from any action by creditors to collect debts existing on the date the bankruptcy was filed. *See* Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 BANKR. DEVS. J. 485, 487 (1993). Individuals receive a discharge as long as they do not trigger any of the grounds for denial of a discharge contained in § 727(a). *See* 11 U.S.C. § 727(a).

excess of his living expenses.[53]

A. *Bankruptcy Under Early English Law*

People who could not pay their debts have not always had the option of walking away from them. English debtors were subjected to torture,[54] imprisonment,[55] and at times even death.[56] In the sixteenth century, English creditors were permitted to pursue their claims collectively against merchant debtors[57] in response to a debtor's "acts of bankruptcy."[58] These "acts" related not to the debtor's financial condition but to his behavior, such as abandoning his business and moving away.[59] Creditors could then appoint a commission and collect and sell the debtor's assets.[60] If creditors were not paid in full through this process, however, each creditor

53. *See* BENJAMIN WEINTRAUB & ALAN N. RESNICK, BANKRUPTCY LAW MANUAL ¶ 3.01, at 3-2 to -3 (4th ed. 1996); *see also* Block-Lieb, *supra* note 6, at 37 (discussing pro bono representations of consumer debtors).

54. *See* Ian P.H. Duffy, *English Bankrupts, 1571-1861*, 24 AM. J. LEGAL HIST. 283, 284-86 (1980). Professors Baird and Jackson have noted that from the debtor's perspective, the early English laws were viciously punitive. *See* DOUGLAS BAIRD & THOMAS JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 27-28 (2d ed. 1990).

55. *See* Jay Cohen, *The History of Imprisonment for Debt and Its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153, 154-55 (1982). "The common law writs of *capias* authorized 'body execution,' i.e., seizure of the body, held until payment of the debt." Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 7 (1995).

56. *See* MAX FARRAND, THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 489 (1966); Kurt H. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215, 217 n.9 (1957).

57. As commerce expanded, the need for a collective procedure to collect debts became evident. In 1542, during the reign of Henry VIII, the first bankruptcy law was passed in England. *See* An Act Against Such Persons as Do Make Bankrupts, 34 & 35 Hen. 8, ch. 4 (1542) (Eng.). "This law viewed debtors as quasi-criminals and placed additional remedies in the hands of creditors." Tabb, *supra* note 55, at 7.

58. The ground for commencing a bankruptcy proceeding by the creditor was the commission of an "act of bankruptcy" by the debtor, which indicated that the debtor was attempting to prevent creditors from recovering on debts justly owed them. *See* Israel Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189, 193-94 (1938). For example, one act of bankruptcy was "keeping house," whereby the debtor would confine himself to his home, away from the reach of creditors. *See* Tabb, *supra* note 55, at 8. These "acts" related not to a debtor's financial condition but to his resulting behavior, such as abandoning his business and moving away. For a further discussion of acts of bankruptcy, see 2 WILLIAM BLACKSTONE, COMMENTARIES *477-79. In response to this behavior to escape paying debts, creditors could petition for the appointment of a commission to collect and sell the debtor's assets and distribute them to creditors. *See* Smith v. Mills, 76 Eng. Rep. 441, 473-74 (K.B. 1584).

59. *See* 2 BLACKSTONE, *supra* note 58, at *477-79.

60. *See Smith*, 76 Eng. Rep. at 473-74.

retained its right to recover from and levy against the debtor and his future property.[61] Thus, bankruptcy laws in England were initially used to achieve the sole objective of improving the likelihood of collecting creditors' debts.[62]

It was not until the Statute of Anne[63] was enacted in 1705 that the concept of discharge was born. Titled "An Act to Prevent Frauds Frequently Committed by Bankrupts," the statute was an attempt to remedy problems creditors had in locating debtors' assets by rewarding debtors who helped with the collection process and reprimanding those who did not.[64] Debtors who cooperated fully received a limited form of discharge and fifty percent of what was collected.[65] Those who lied or otherwise failed to cooperate were put to death.[66] Given the punishment for failing to comply, it is hard to

61. *See* An Act Against Such Persons as Do Make Bankrupts, 34 & 35 Hen. 8, ch. 4, § 6. If creditors were not paid off in full, "then the said creditor or creditors, and every [one] of them, shall and may have their remedy for the recovery and levying of the residue of the same debts or duties ... in like manner and form as they should and might have had before the making of this act." *Id.*

62. *See* Treiman, *supra* note 58, at 193. Parliament periodically amended the bankruptcy laws, especially in the seventeenth century, to enhance the power of the bankruptcy commissioners to reach more of the debtor's assets and to increase the penalties against noncompliant debtors. *See* An Act for the Further Description of a Bankrupt, and Relief of Creditors Against Such as Shall Become Bankrupts, and for Inflicting Corporal Punishment upon the Bankrupts in Some Special Cases, 21 Jam., ch. 19, § 8 (1623) (Eng.). For example, the commissioner was empowered to break into the debtor's house or shop to seize the debtor's property, thus eliminating the effectiveness of "keeping house." *See id.*

63. An Act to Prevent Frauds Frequently Committed by Bankrupts (Statute of Anne), 4 Anne, ch. 17 (1705) (Eng.).

64. *See id.* The statute provided that "all and every person and persons so becoming bankrupt ... who shall ... in all things conform ... shall be discharged from all debts by him, her, or them due and owing at the time that he, she or they did become bankrupt." *Id.* § 7. "[Although] the quasi-criminal nature of bankruptcy remained, the Statute of Anne first established the roots of a more humanitarian treatment of honest but unfortunate debtors." Tabb, *supra* note 55, at 10.

65. *See* Tabb, *supra* note 55, at 9 ("A cooperative debtor was granted a monetary allowance out of the bankruptcy estate, the amount of which depended on the percentage dividend that was paid to creditors.").

66. The capital punishment provision in the Statute of Anne provided that uncooperative debtors would "suffer as a felon without the benefit of clergy," the English terminology for the death penalty. An Act to Prevent Frauds Frequently Committed by Bankrupts (Statute of Anne), 4 Anne ch. 17, § 18 (Eng.); *see* Douglas G. Baird, *A World Without Bankruptcy*, 50 LAW & CONTEMP. PROBS., Spring 1987, at 173, 174 n.6. (noting that one debtor was executed for failing to respond to a notice to appear before a bankruptcy commission, despite his claim that he had no knowledge of the notice because he was in Scotland, and that another debtor was executed for trying to hide some bank notes from his creditors after being found a bankrupt).

say whether the discharge itself created any incentive to cooperate.[67]

English law eventually became less barbaric, replacing the threat of death for nonpayment with imprisonment.[68] Debtors' prisons caused additional problems, however, including burdening the state with the ongoing expense of maintaining the debtor prisoner and his family.[69] Even after debtors were released from prison, existing debts were often substantial enough to eliminate any chance of ever repaying them.[70]

B. *The History of and Policies Behind Discharge Theory in American Bankruptcy Jurisprudence*

The United States Constitution empowers Congress to establish uniform laws on the subject of bankruptcy throughout the United States,[71] but gives no guidance regarding what these uniform laws

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67. A discharge under the Statute of Anne required creditor consent and was not an automatic entitlement. *See* An Act to Prevent Frauds Frequently Committed by Bankrupts (Statute of Anne), 5 Anne ch. 22, § 2 (1706) (Eng.). The commissioners had to certify that the debtor had "conformed" to the requirements of the Act, meaning that the debtor cooperated in the bankruptcy proceeding. *See id.* Further, the discharge would leave the debtor with no more than five pounds per hundred of the net estate, not to exceed two hundred pounds. *See id.* § 7. Thus, the creditor consent provision seriously undercut any beneficial effect of the discharge.

68. *See* Statute of Marlbridge, 52 Hen. 3, ch. 23 (1267) (Eng.) (authorizing the detention of a debtor), *cited in* Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 140 (1819); *see also* Cohen, *supra* note 55, at 154 (noting that the Statute of Marlbridge was the first statute to provide for detention of a debtor). The English law realized that debtors' prisons did not guarantee return of a creditor's money but instead merely incarcerated debtors in the hope of curbing credit abuse. *See* 8 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 230-31 (1966).

69. *See* PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900, at 249-52 (1974) (noting that "the New World as well as the Old [had] to re-evaluate the concept of imprisonment for debt"). The cost of maintaining debtors in prison was eventually passed off to creditors to make the weekly support payments. *See* 11 HOLDSWORTH, *supra* note 68, at 597.

70. *See* COLEMAN, *supra* note 69, at 250 (noting that both in England and in colonial America, some debtors "never lifted themselves out of their poverty and lived out their wretched lives as wards of the public or subsisted on private charity"). The Debtors Act of 1869 abolished imprisonment for debt and released the remaining debtors. *See* Debtors Act, 32 & 33 Vict., ch. 62, § 4 (1869) (Eng.). However, the statute retained six exceptions to the abolition of imprisonment, including imprisonment of petty debtors who refused to pay and imprisonment of fraudulent debtors. *See id.* In any case, though, imprisonment was limited to one year. *See id.*

71. *See* U.S. CONST. art. I, § 8, cl. 4 ("The Congress shall have [the] Power to ... establish ... uniform Laws on the subject of Bankruptcies throughout the United States."). This clause was added late in the proceedings of the Constitutional Convention, after very little debate. *See* FARRAND, *supra* note 56, at 447. Charles Pinckney of South Carolina is generally credited with first drafting the Bankruptcy Clause. *See id.* Roger Sherman of Connecticut cast the only vote against the Bankruptcy Clause in the fear that

should contain.[72] Bankruptcy laws in this country were historically involuntary laws designed to aid creditors in collection efforts.[73] A separate set of provisions called "insolvency laws" were enacted to provide debtors with a discharge from debtors' prison if they voluntarily handed over their property.[74] This was not to say that their *debts* were discharged;[75] to the contrary, creditors who were not paid in full from the sale of the debtors' assets could continue to pursue their claims after bankruptcy.[76]

Eventually, after decades of negotiations between debtor and mercantile (creditor) interests, a series of American bankruptcy acts were enacted that combined the involuntary elements of bankruptcy with the voluntary aspects of discharge from prison.[77] After many other attempts at successful bankruptcy legislation had failed, the Bankruptcy Act of 1898 was enacted.[78] The Act of 1898 represented

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debtors could be put to death. *See* Burton Perlman, *"A View from the Bench,"* 61 U. CIN. L. REV. 397, 513-14 (1992).

72. The subject of bankruptcy received only passing attention at the Constitutional Convention of 1787. *See* Frank R. Kennedy, *Bankruptcy and the Constitution*, 33 U. MICH. L. QUADRANGLE NOTES, Spring 1989, at 40, 40. However, the framers believed that bankruptcy deserved federal protection because of varying and discriminatory state laws. *See id.*

73. The first of these, the Bankruptcy Act of 1800, Act of Apr. 4, 1800, ch. 19, 2 Stat. 19, *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248, offered very little help to debtors. In fact, only creditors could initiate a bankruptcy proceeding, and, although discharge was available, it was granted only under stringent circumstances. *See* Tabb, *supra* note 55, at 14-15. Also, only merchants were eligible debtors under the act. *See id.*

74. *See* Bankruptcy Act of 1800, ch. 19, § 18, 2 Stat. at 26 (requiring that a debtor "fully and truly disclose and discover all his or her effects and estate, real and personal"). The debtor was also required to produce his books and accounts, and transfer all of his estate, except for exempt property, to the assignees. *See id.* ch. 19, § 18, 2 Stat. at 27.

75. The discharge was not a matter of right but depended on approval by the creditors and bankruptcy commissioners. *See* Charles Jordan Tabb, *The History of the Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 346 (1991). Moreover, creditors were still allowed to bring post-discharge proceedings against the debtor. *See id.* at 348. In those areas, the burden of invoking the benefits of the "certificate of discharge" fell upon the debtor. *See id.*

76. *See* Bankruptcy Act of 1800, ch. 19, § 34, 2 Stat. at 30-31 (providing that a debtor could raise the discharge as an affirmative defense if sued on or arrested for any debt).

77. The first federal bankruptcy law existed only from 1800 to 1803 and only provided relief for a small number of financiers and speculators. *See* COLEMAN, *supra* note 69, at 20. The Act of 1800 failed because of its bias toward mercantile interests over agriculture and the widespread belief of debtor abuse. *See* BRANDENBURG ON BANKRUPTCY § 3, at 5 (W. Oppenheimer ed., 4th ed. 1917). Congress thereafter attempted to enact national bankruptcy policies through the Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841) (repealed 1843), the Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (repealed 1878), and finally the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (repealed 1978). *See* Tabb, *supra* note 75, at 326.

78. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (current version at 11 U.S.C.

a compromise between debtor and creditor interests and provided for the first time a general discharge of indebtedness.[79]

In the years leading up to the enactment of the Act of 1898, the need for such a discharge became widely recognized. In a colorful 1864 Congressional debate about whether to provide such a discharge, Representative Jenckes remarked:

> Why should this state of things continue? Of what advantage can it be to creditors or to the country that so many tens of thousands of active men of the country should be held in thralldom? They bear upon their limbs no visible chains; they have no masters who will yield them food for their toil, yet they are in the power of those who may sweep off their earnings at any time, and in some states may incarcerate their persons in prison .... What to them are the guarantees of the Constitution? Why should they love the Government and yield it hardy allegiance? Many, indeed, have gone forth to the war for its support, to lay their bones upon the battle-fields, ... [only] to return to a life-long servitude and degradation. The fault is here and not with them or with the Constitution if they owe it slack allegiance .... It rests with Congress alone to say whether more than a hundred thousand of the most intelligent, most active, and most patriotic men of the country should have the opportunity of liberating themselves from their bondage of debt, and walk free in the exercise of those rights which the immortal Declaration declares inalienable.[80]

Thus, while the original philosophy behind granting a discharge had more to do with improving collection efforts than providing a fresh start, Congress eventually saw added societal benefits in granting a fresh start.[81] A person with no hope of achieving any success in society would be unwilling, or perhaps unable, to express allegiance to our nation and its safety.[82]

§§ 101-1330 (1994)).

79. *See* Tabb, *supra* note 75, at 325 (noting that while the Bankruptcy Acts of 1841 and 1867 allowed voluntary bankruptcy for debtors other than merchants, the Acts did not allow voluntary discharge). The 1898 Act removed the requirement of either creditor consent or minimum dividend as a prerequisite to obtaining a discharge. *See id.* at 364. The only checks on discharge that remained were those spelled out by Congress in the Act. *See id.*

80. CONG. GLOBE, 38th Cong., 1st Sess. 2638 (1864) (remarks of Rep. Jenckes).

81. *See* Tabb, *supra* note 75, at 364 (noting that the Act of 1898 recognized for the first time the overriding public interest in granting a discharge to "honest but unfortunate" debtors).

82. *See id.* at 364-65 (noting that the social utility theory supporting discharge is that society as a whole benefits when a debtor is freed from the oppressive weight of debt).

The discharge and certain related debtor protections provided some debtor relief.[83] Through the development of the large-scale consumer economy in the 1950s and 60s, however, creditors became far more savvy about protecting themselves against bad debts.[84] Demanding liens in personal property, a practice unheard of prior to that time, became common.[85] For the first time, creditors obtained security interests in a debtor's household goods, furnishings, and even automobiles.[86] Having obtained liens even on a debtor's most necessary personal items, which could be enforced both during and after bankruptcy, creditors could repossess the items if the debtor did not pay for them.[87] Consequently, creditors obtained bargaining power that far outweighed the value of their collateral.[88]

Additionally, enforcement of the discharge provisions contained in the Act of 1898, which was the operative statute until 1978, was virtually impossible. Enforcement of the discharge was left to state courts, which—due to the bankruptcy courts' loss of jurisdiction over fully adjudicated bankruptcy cases—could ignore the discharge and permit creditors to pursue debtors for discharged debts.[89] Even as recently as the 1960s, the bankruptcy courts had no ability to enforce a discharge, providing a major impetus for Congress to grant exclusive jurisdiction of all bankruptcy matters to bankruptcy courts

83. As Peter Coleman noted in his book about the history of bankruptcy in America:

> The Bankruptcy Act of 1898 incorporated five fundamental principles. It relieved all debts, not just ones arising out of contracts entered into after the law went into effect; it permitted both voluntary and involuntary bankruptcy; it applied to all business corporations, including national banks, but exempted farmers and wage earners from the involuntary provisions; it protected whatever property was exempt under state law from attachment; and it provided procedures by which insolvent debtors could have a grace period in which to reorganize their affairs or reach compositions with their creditors.

COLEMAN, *supra* note 69, at 29.

84. *See* DAVID CAPLOVITZ, CONSUMERS IN TROUBLE: A STUDY OF DEBTORS IN DEFAULT 4-6 (1974).

85. *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. REP. NO. 93-137, pt. 1, at 169 (1973).

86. *See* Note, *Bankruptcy Exemptions: Critique and Suggestion*, 68 YALE L.J. 1459, 1470 n.78 (1959).

87. Although most states provided exemption for at least basic items, blanket liens were still enforceable against the debtor because they were consensual agreements. *See* Richard S. Davis, Comment, *Protection of a Debtor's "Fresh Start" Under the New Bankruptcy Code*, 29 CATH. U. L. REV. 843, 848 (1980).

88. *See* H.R. REP. NO. 93-137, at 169.

89. *See* Doug Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C. L. REV. 723, 732-33 (1980) (noting that judges allowed creditors to secure reaffirmation of debt despite the language of the 1898 Act prohibiting creditors from "instituting or continuing any action or employing any process to collect").

in the Bankruptcy Code enacted in 1978.[90]

Many reasons have been espoused for granting an individual debtor a discharge of indebtedness, including debtor rehabilitation, preservation of the credit-based economy, providing insurance against insolvency, and even preservation societal resources.[91] A person who owes a significant amount of his future salary to creditors may be unmotivated to continue working and making an economic contribution to society.[92] It also makes more sense to put the risk of poor credit decisions on creditors, who presumably are in a better position to absorb the losses and to determine whether credit should be issued in the first place.[93] Additionally, when public assistance programs were more readily available, granting a general bankruptcy discharge saved public assistance funds by providing an additional safety net that could keep a person from resorting to public assistance.[94] The most compelling of all reasons to grant a discharge is economic: you cannot get blood from a stone and it is a colossal waste of societal resources to try.[95]

Despite many good reasons for granting a bankruptcy discharge, the existence of this policy remains controversial.[96] The bankruptcy discharge may increase the overall cost of credit, which is borne by people who pay their debts.[97] Moreover, the credit industry

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90. *See id.* at 727 ("The [1898] Act split jurisdiction ... between federal bankruptcy courts and state courts with general jurisdiction."). A state court could later review a federal bankruptcy discharge decision and determine the effect of that discharge, provided, however, that the state court did not frustrate the discharge. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 243 (1934); Rendleman, *supra* note 89, at 727.

91. *See* Jackson, *supra* note 35, at 1404-24; Luther Zeigler, Note, *The Fraud Exception to Discharge in Bankruptcy: A Reappraisal*, 38 STAN. L. REV. 891, 894 (1986).

92. *See* Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 94 (1990) (noting that the social utility theory on discharge includes the notion that a debtor under the weight of garnishment has little incentive to work).

93. *See* Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1067 (1987) (noting the belief held by some that consumer credit is too easy to get).

94. *See* Jackson, *supra* note 35, at 1402 (arguing that a debtor may rely on social welfare programs in the event of no right of discharge).

95. The financial panics of 1837 and 1851 exemplify the strain on what Professor Tabb calls the "fabric of society." Tabb, *supra* note 92, at 94. That is, the existence of a large class of debtors causes financial hardship on the rest of society. *See id.*

96. *See id.* at 97 ("Historical evidence suggests that most people do not want a totally humanitarian or merciful system that allows all debtors to walk free, no matter what their moral worthiness."); *see also* Philip Shuchman, *An Attempt at a "Philosophy of Bankruptcy,"* 21 UCLA L. REV. 403, 421 (1973) (arguing that the original rationale for discharge was to encourage honest people to cooperate with the bankruptcy court).

97. *See* Tabb, *supra* note 92, at 96 (noting that many creditors contribute to the debt

consistently has argued that liberal discharge policies lead to abuse and that bankruptcy and the resulting discharge are available to consumers who simply do not need this form of relief.[98] Given the competing interests of the credit industry on the one hand, and consumers on the other, this debate is likely to continue as long as society remains credit-based.[99]

IV. THE BANKRUPTCY CODE'S FRESH START SCHEME

Despite disagreements about whether there should be a discharge policy, the Bankruptcy Code is clear: discharge shall be liberally granted and any provision to deny or limit a discharge must be construed strictly in favor of the debtor and against the objecting creditor.[100] The creditor has the burden of proof with respect to discharge and must produce sound, credible evidence justifying the relief requested.[101]

In addition to its discharge provisions, the Bankruptcy Code also contains a complex system of related debtor protections that ensure that the debtor's fresh start is real and not illusory.[102] A debtor may

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problem by encouraging overuse of credit).

98. *See* Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953, 977 (1981); Howard, *supra* note 93, at 1069; Jackson, *supra* note 35, at 1427.

99. *See* Tabb, *supra* note 92, at 89-99 (discussing various normative rationales for granting a bankruptcy discharge as well as arguments against granting such a discharge).

100. *See* 11 U.S.C. § 727(a) (1994). As stated in the Report of the House Judiciary Committee, "the bill ... enunciates a bankruptcy policy favoring a fresh start." H.R. REP. NO. 95-595, at 126 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6087. When presented with an objection to discharge, we must be "especially circumspect" in light of these important considerations. *See* MacLeod v. Arcuri (*In re* Arcuri), 116 B.R. 873, 878 (Bankr. S.D.N.Y. 1990). The court is required to construe the objection strictly against the objectant and liberally in the debtor's favor. *See In re* Tabibian, 289 F.2d 793, 795 (2d Cir. 1961); Barnett Bank v. Muscatell (*In re* Muscatell), 113 B.R. 72, 73 (Bankr. M.D. Fla. 1990); Ray v. Graham (*In re* Graham), 111 B.R. 801, 805 (Bankr. E.D. Ark. 1990); Continental Ill. Nat'l Bank & Trust Co. v. Bernard (*In re* Bernard), 99 B.R. 563, 569 (Bankr. S.D.N.Y. 1989); American State Bank v. Montgomery (*In re* Montgomery), 86 B.R. 948, 955 (Bankr. N.D. Ind. 1988); First Fed. Sav. & Loan Ass'n v. Johnson (*In re* Johnson), 82 B.R. 801, 804 (Bankr. E.D.N.C. 1988); Sinkon v. Latimer (*In re* Latimer), 82 B.R. 354, 359 (Bankr. E.D. Pa. 1988); Giel v. Brooks (*In re* Brooks), 58 B.R. 462, 464 (Bankr. W.D. Pa. 1986); Scarsdale Nat'l Bank & Trust Co. v. Switzer (*In re* Switzer), 55 B.R. 991, 997 (Bankr. S.D.N.Y. 1986).

101. *See* Ohio Co. v. Maynard (*In re* Maynard), 162 B.R. 349, 353 (M.D. Fla. 1993) (stating that "[t]he party objecting to the Debtor's discharge has the burden of proving by a mere preponderance of the evidence that the Debtor's discharge should be denied"). In addition, the creditor must timely request that the bankruptcy court consider the nondischargeability of the debt. *See* 11 U.S.C. § 523(a)(3)(B). Otherwise, the debt will be discharged. *See id.*

102. The discharge injunction, as one of these protections, voids all judgments on discharged debts and bans "an act, to collect, recover or offset any such debt as a personal liability of the debtor." 11 U.S.C. § 524(a)(2); *see also* DAVID T. STANLEY ET AL.,

now exempt a variety of valuable property under the federal exemptions, or may opt for the state law exemptions.[103] A debtor also may avoid certain judgment liens, including liens that interfere with exempt property, thus modifying creditors' rights in secured property.[104] The debtor also may utilize the trustee's avoiding powers to recover exempt property[105] and can redeem certain consumer property.[106] Moreover, government agencies are precluded from discriminating against a person merely because she has filed for bankruptcy.[107]

The automatic stay enjoins the commencement or continuation of any action to collect a discharged debt.[108] The stay prevents recovery of the debt from the debtor or his property and operates as an injunction, whether or not discharge of the debt is waived.[109] Finally, and perhaps most importantly, the broad jurisdiction granted to bankruptcy courts under the Bankruptcy Code[110] provides

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BANKRUPTCY: PROBLEM, PROCESS, REFORM 60-62 (1971) (noting that a creditor is barred from pursuing a debtor.for pre-petition debts after discharge).

103. *See* 11 U.S.C. § 522(b)(1) (1994); Veryl Victoria Miles, *A Debtor's Right to Avoid Liens Against Exempt Property Under Section 522 of the Bankruptcy Code: Meaningless or Meaningful?*, 65 AM. BANKR. L.J. 117, 118 (1991). A debtor domiciled in a state that "opts out" may elect only those exemptions authorized by state law. *See* Marc S. Cohen & Kenneth N. Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N.C. L. REV. 681, 688-91 (1980) (noting that typical state law exemptions might allow a debtor to exempt a variety of property, including limited personal property, various disability and social security benefits provided by federal law, and, in some states, property owned as tenants by the entireties).

104. *See* 11 U.S.C. §§ 522(f), 724(a).

105. *See id.* § 522(f). The debtor, in effect, stands in the trustee's shoes to recover property on his own behalf. For example, a debtor may recover exempt property transferred involuntarily and without bad faith. *See id.* § 522(g).

106. *See id.* § 722. This provision allows a debtor to redeem personal tangible property exempt under § 522. *See id.* This thwarts the common practice by creditors of taking security interests in the debtor's household goods, automobile, etc. *See* Margaret Howard, *Stripping down Liens: Section 506(d) and the Theory of Bankruptcy*, 65 AM. BANKR. L.J. 373, 389 (1991).

107. *See* 11 U.S.C. § 525 (codifying the holding of *Perez v. Campbell*, 402 U.S. 637 (1971)). The provision prohibits discrimination with respect to licenses, employment, etc. *See id.*

108. *See id.* § 362(a)(6) (providing the debtor with a "stay," which forbids the creditor from attempting to "[c]ollect, assess, or recover a [pre-bankruptcy] claim").

109. *See id.* § 362. This provision in § 522 generally applies to unsecured creditors only. However, § 522(f) property lies beyond the reach of most unsecured *and* secured creditors. *See* H.R. REP. No. 95-595, at 362 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6318.

110. *See* 28 U.S.C. § 151 (1994). In the 1982 case of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the Supreme Court held bankruptcy court jurisdiction under 28 U.S.C. § 1471 (Supp. IV 1976) unconstitutional because the Code granted Article III "judicial power" to non-Article III bankruptcy courts. *See Northern Pipeline*, 458 U.S. at 87. Congress responded—albeit belatedly—to the Court's

bankruptcy courts with the absolute ability to enforce the discharge and related debtor protections.[111] Taken together, these provisions shield the debtor from all actions taken by creditors whose debts have been discharged,[112] absolutely forbid creditors from making any attempt to collect a pre-petition debt,[113] and produce what has been described as the most extensive debt relief system since the Biblical seven-year release.[114]

V. LIMITATIONS ON DISCHARGE

In order to protect against abuses by bankruptcy debtors during bankruptcy cases, to punish certain pre-petition behavior, and to protect certain debts from discharge, Congress enacted exceptions to the general right of discharge.[115] Discharge may be limited in two ways: either a particular debt may be excepted from discharge,[116] or a

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ruling by providing a different form of jurisdiction for bankruptcy courts in the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). *See* 28 U.S.C. § 151. Under BAFJA, bankruptcy courts act as an arm of the district courts and hear cases only by reference from the district courts. *See id.*

111. *See* Kimberli A. Cary, *The Arsenal of Sanctionary Powers at the Bankruptcy Court's Disposal*, 13 BANKR. DEVS. J. 443, 449-50 (1997) (noting that after *Northern Pipeline*, Congress amended BAFJA to provide for the current jurisdictional scheme). However, district courts review de novo bankruptcy court decisions relating to "non-core" matters. *See* 28 U.S.C. § 157(b), (c).

112. The invalidation of judgments and injunctions against creditors offers debtors the greatest benefit. *See* 11 U.S.C. § 524.

113. *See id.* § 362.

114. *See* Guardian Indus. Prods., Inc. v. Diodati (*In re* Diodati), 9 B.R. 804, 809 (Bankr. D. Mass. 1981). The Book of Deuteronomy documents the "Hebrew Jubilee": "At the end of every seven years you shall grant a release. And this is the manner of the release: every creditor shall release what he has lent to his neighbor; he shall not exact it of his neighbor, his brother, because the Lord's release has been proclaimed." *See Deuteronomy* 15:1-2.

115. *See* 11 U.S.C. §§ 523, 727. As with each form of bankruptcy relief available under the Bankruptcy Code, however, § 727 attempts to compromise diametrically opposed interests. Whereas a discharge from debts is the debtor's "ultimate goal," the law's predilection to afford financial relief is not "meant to protect the dishonest debtor." WEINTRAUB & RESNICK, *supra* note 53, at ¶ 3-2; *see* Standard Chartered Bank, P.L.C. v. Kelpach (*In re* Bonanza Import & Export, Inc.), 43 B.R. 570, 575 (Bankr. S.D. Fla. 1984). A discharge under § 727 is a privilege, not a right. It may be "granted [only to] the honest debtor." *In re* Tabibian, 289 F.2d 793, 794 (2d Cir. 1961); *see* McManus v. McManus (*In re* McManus), 112 B.R. 773, 775 (Bankr. E.D. Va. 1990) (noting that bankruptcy is a "privilege"); Discenza v. MacDonald (*In re* MacDonald), 50 B.R. 255, 259 (Bankr. D. Mass. 1985) (noting that a debtor has "no inherent right to a discharge"). This provision is designed to prevent a dishonest debtor from utilizing the law's protection to shield wrongdoing. *See* Chittenden Trust Co. v. Mayo (*In re* Mayo), 94 B.R. 315, 319 (Bankr. D. Vt. 1988) (stating that § 727 is in place to prevent dishonest debtors from using the fresh start to the detriment of honest creditors).

116. *See* 11 U.S.C. § 523(a).

debtor's entire discharge can be denied.[117] Objections to discharge of a particular debt focus primarily on debt created by a debtor's pre-petition actions, which caused specific damage to a particular creditor.[118] For example, if a debtor presents a false financial statement to a lender who relies on the statement in granting credit,[119] the individual creditor who granted the credit can object to the dischargeability of its particular debt. Another example of non-dischargeable pre-petition debt is that resulting from pre-petition embezzlement by an employee.[120] Some debts that are excepted from discharge are nondischargeable, not because of a debtor's improper actions toward the creditor, but because of the type of debts involved. Examples include debts for certain taxes as well as alimony and child support.[121]

Objections to a general discharge focus primarily (though not exclusively) on improper conduct during, as opposed to prior to, the bankruptcy case.[122] Examples include false statements made on the bankruptcy petition or in another aspect of the case, and a failure to disclose assets in the bankruptcy disclosure documents.[123] Because full disclosure is considered central to a fair bankruptcy system,[124] failure to disclose relevant facts in a bankruptcy case is considered far more serious than failing to do so in some context prior to a bankruptcy case.[125] Consequently, a debtor's knowingly false or incomplete disclosures warrant denial of a his entire discharge, and

117. *See id.* § 727(a).

118. *See id.* § 523(a)(2)(B) (excepting from discharge any debt incurred by means of a materially false and intentionally deceptive statement upon which a creditor relied).

119. *See id.*

120. *See id.* § 523(a)(5).

121. *See id.* § 523(a)(1) (taxes); *id.* § 523 (a)(5) (alimony and child support).

122. *See id.* § 727(a).

123. *See* Ohio Co. v. Maynard (*In re* Maynard), 162 B.R. 349, 355 (Bankr. M.D. Fla. 1993) (stating that failure to disclose transfer of tax refund check to wife and lying about it at the § 341 hearing justified denial of a discharge); Davis v. Davenport (*In re* Davenport), 147 B.R. 172, 181 (Bankr. E.D. Mo. 1992) (stating that failure to disclose transfer of over $339,000 to son justified denial of discharge).

124. *See* Boroff v. Tully (*In re* Tully), 818 F.2d 106, 110 (1st Cir. 1987) (noting the importance of full disclosure in bankruptcy cases).

125. For example, under the "clean hands" doctrine, release of liability is barred for misconduct. *See* DAN B. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 45-47 (1973). The "clean hands" rationale punishes debtor misconduct and protects creditors not on equal footing with creditors who relied on accurate information concerning the debtor's credit. *See* H.R. REP. NO. 95-595, at 130 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6091 (noting that the fraud exception to discharge protects those creditors who rely on fraudulent information).

not mere exception of a particular debt from discharge.[126] Because most petitions contain some minor errors, and because a truly knowing false oath could result in a jail term, creditors can extract a debtor's promise to pay his or her debts merely by threatening to bring a false oath complaint as a result of these mistakes.

In the following subsections, this Article describes the purpose of denial of a general discharge for a false oath, as well as the unique potential for abuse created by the circumstances surrounding these objections. In order to determine what sanctions would be appropriate to impose in the case of unsuccessful objections to a debtor's general discharge, this Article then analyzes the sanctions that Congress chose to impose for unsuccessful objections to discharge of a particular debt.

A. *Objections to a Debtor's General Discharge Under Section 727(a)*

Compared to an objection to the dischargeability of a particular debt, discussed below, objection to a debtor's entire discharge is serious business.[127] This is particularly true of fraud-based objections instituted under § 727(a)(4), which provides that a debtor who knowingly and fraudulently makes a materially false statement in or in connection with her case[128] will be denied a general discharge.[129]

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126. *See* 11 U.S.C. § 727(a)(4) (providing that a general discharge will be denied if the debtor makes a knowing and fraudulent false oath or omission).

127. One author has noted that

> [i]f an objecting creditor successfully maintains an action under section 523, the debtor still receives a discharge, however the particular debt owed to the objecting creditor is excepted from that discharge. In contrast, a successful action under section 727(a) denies the debtor discharge of all debts. *The severity of a successful action under section 727(a) is clearly more adverse to the debtor than a successful action under section 523(a).*

Craig A. Barbarosh, Comment, *Application of a Heightened Standard of Proof Is Not Very Clear and Convincing Under 11 U.S.C. Section 727(a)*, 22 PAC. L.J. 1205, 1214 (1991) (footnotes omitted) (emphasis added). If discharge is denied, the debtor remains liable for all pre-petition debts that the debtor incurred, thus frustrating the fresh start policy. *See* 1 DANIEL R. COWANS ET AL., BANKRUPTCY LAW & PRACTICE § 5.1 (1989); *see also* Chittenden Trust Co. v. Mayo (*In re* Mayo), 94 B.R. 315, 328-29 (Bankr. D. Vt. 1988) ("Compared to the nondischargeability result of a successful § 523(a) attack, a successful § 727 proceeding is the equivalent of all out nuclear war on the debtor.").

128. *See* 11 U.S.C. § 727(a)(4). Materiality generally means that the false statement or nondisclosure relates to the debtor's case or her business transactions, or concerns discovery of assets or the disposition or existence of assets. *See* Mertz v. Rott, 955 F.2d 596, 598 (8th Cir. 1992).

129. *See* Swicegood v. Ginn, 924 F.2d 230, 232 (11th Cir. 1991) ("To justify denial of discharge under § 727(a)(4)(A), the false oath must be fraudulent and material."); Palentine Nat'l Bank v. Olson (*In re* Olson), 916 F.2d 481, 483-84 (8th Cir. 1990) (requiring materiality in order to deny general discharge on basis of fraud).

The purpose of this provision is to ensure that the debtor provides honest and reliable information in her bankruptcy case and that the bankruptcy trustee has access to all assets and information needed to administer the estate effectively.[130] Put another way, the debtor may not play fast and loose with the bankruptcy process but must describe fact rather than fiction in her disclosures.[131] Disclosure, then, is a prerequisite to receipt of a bankruptcy discharge.[132]

Legitimate grounds upon which to object to a debtor's general discharge include a failure to disclose all property,[133] all income,[134] or

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130. *See In re* Tabibian, 289 F.2d 793, 797 (2d Cir. 1961); Barnett Bank v. Muscatell (*In re* Muscatell), 113 B.R. 72, 74 (Bankr. M.D. Fla. 1990); Kriseman v. Ingersoll (*In re* Ingersoll), 106 B.R. 287, 293 (Bankr. M.D. Fla. 1989); Camacho v. Martin (*In re* Martin), 88 B.R. 319, 323 (D. Colo. 1988); First Fed. Sav. & Loan Ass'n v. Johnson (*In re* Johnson), 82 B.R. 801, 805 (Bankr. E.D.N.C. 1988); Butler v. Ingle (*In re* Ingle), 70 B.R. 979, 983 (Bankr. E.D.N.C. 1987); Schultz v. Shapiro (*In re* Shapiro), 59 B.R. 844, 849 (Bankr. E.D.N.Y. 1986); *In re* Shebel, 54 B.R. 199, 202 (Bankr. D. Vt. 1985); Discenza v. MacDonald (*In re* MacDonald), 50 B.R. 255, 295 (Bankr. D. Mass. 1985); Guardian Indus. Prods., Inc. v. Diodati (*In re* Diodati), 9 B.R. 804, 807 (Bankr. D. Mass. 1981); *see also* Wines v. Wines (*In re* Wines), 114 B.R. 794, 797 (Bankr. S.D. Fla. 1990) (stating that a "debtor has a paramount duty to consider all questions posed on a statement or schedule carefully and see that the question is answered completely in all respects"); Giel v. Brooks (*In re* Brooks), 58 B.R. 462, 467 (Bankr. W.D. Pa. 1986) ("[D]ebtor must provide all of the necessary information."); LaVangie v. Mazzola (*In re* Mazzola), 4 B.R. 179, 182 (Bankr. D. Mass. 1980) (stating that the "trustee and creditors are entitled to honest and accurate sign posts on the trail showing what property has passed through the bankrupt's hands during a period prior to his bankruptcy").

131. *See* Boroff v. Tully (*In re* Tully), 818 F.2d 106, 110 (1st Cir. 1987). The First Circuit has held that

> the very purpose of certain sections of the law, like 11 U.S.C. § 727(a)(4)(A), is to make certain that those who seek the shelter of the bankruptcy code do not play fast and loose with their assets or with the reality of their affairs. The statutes are designed to insure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction.... Neither the trustee nor creditors should be required to engage in a laborious tug-of-war to drag the simple truth into the glare of daylight. The bankruptcy judge must be deft and evenhanded in calibrating these scales.

Id. (citations omitted).

132. *See, e.g.*, Windmiller v. Evans (*In re* Evans), 106 B.R. 722, 723 (Bankr. M.D. Fla. 1989); Scarsdale Nat'l Bank & Trust Co. v. Lubin (*In re* Lubin), 61 B.R. 511, 513 (Bankr. S.D.N.Y. 1986); *see also* Ray v. Graham (*In re* Graham), 111 B.R. 801, 806 (Bankr. E.D. Ark. 1990) (holding that disclosure is a prerequisite to receiving a bankruptcy discharge). Moreover, disclosures should be sufficient to make all necessary facts available to those administering the estate without requiring investigations or examinations to discover the truth of the information provided. *See* Ingersoll v. Kriseman (*In re* Ingersoll), 124 B.R. 116, 122 (M.D. Fla. 1991).

133. *See* Farouki v. Emirates Bank Int'l Ltd., 14 F.3d 244, 250 (4th Cir. 1994); Oldendorf v. Buckman, 173 B.R. 99, 105 (E.D. La. 1994); Scimeca v. Umanoff, 169 B.R. 536, 542 (D.N.J. 1993), *aff'd*, 30 F.3d 1488 (3d Cir. 1994); Mill Creek Lumber & Supply Co. v. Stripling, 135 B.R. 133, 135 (N.D. Okla. 1990), *aff'd*, 947 F.2d 954 (10th Cir. 1991).

all transfers of property of the estate.[135] Discharge also can be denied for knowingly scheduling non-existent debt to a third party[136] and for misrepresenting material facts at a hearing or examination in the case.[137] While discharge may be denied for just one material falsehood or omission, courts frequently view falsehoods in a cumulative fashion.[138] Thus, the existence of more than one knowing falsehood, which the debtor fails to cure through amendment, will lead to a denial of a discharge.[139]

Regardless of the number of inadvertent errors contained in the bankruptcy documents, however, the statute does not deny a discharge because of the debtor's mere inadvertence.[140] In order to deny a general discharge, the falsehood or omission must be "known" to be false.[141] Fraudulent intent is required.[142] Thus neither carelessness, nor vagueness, nor ambiguity alone creates a cause of action under § 727(a)(4).[143] Nor does the statute deny a debtor a discharge based upon the undervaluation of an asset, if the debtor believed in good faith that the value disclosed on the schedule was correct at the time the schedules were completed.[144] Finally, a

134. *See* Dana Fed. Credit Union v. Holt (*In re* Holt), 190 B.R. 935, 939 (Bankr. N.D. Ala. 1996); Youngblood v. Hembree (*In re* Hembree), 186 B.R. 530, 533 (Bankr. M.D. Fla. 1995); Mosley v. Sims (*In re* Sims), 148 B.R. 553, 556 (Bankr. E.D. Ark. 1992).

135. *See* Ohio Co. v. Maynard (*In re* Maynard), 162 B.R. 349, 355 (Bankr. M.D. Fla. 1993) (stating that the failure to disclose transfer of tax refund check to wife and lying about it at the § 341 hearing justified denial of a discharge); Davis v. Davenport (*In re* Davenport), 147 B.R. 172, 181 (Bankr. E.D. Mo. 1992) (stating that the failure to disclose a transfer of over $339,000 to the debtor's son justified denial of discharge).

136. *See* Aubrey v. Thomas (*In re* Aubrey), 111 B.R. 268, 274 (B.A.P. 9th Cir. 1990).

137. *See In re* Maynard, 162 B.R. at 349.

138. *See Oldendorf*, 173 B.R. at 105.

139. *See id.*

140. *See* Behrman Chiropractic Clinics, Inc. v. Johnson (*In re* Johnson), 189 B.R. 985, 993 (Bankr. N.D. Ala. 1995) (holding that inadvertent error is not false oath).

141. 11 U.S.C. § 727(a)(4) (1994) (requiring proof that the debtor "knowingly" *and* "fraudulently" made the misrepresentation).

142. *See id.*; *see also* Garcia v. Coombs (*In re* Coombs), 193 B.R. 557, 565 (Bankr. S.D. Cal. 1996) (holding that carelessness is not what Congress seeks to punish in § 727(a)(4)).

143. *See* 11 U.S.C. § 727(a)(4); *see also* Hays v. Cummins (*In re* Cummins), 166 B.R. 338, 361 (Bankr. W.D. Ark. 1994) (holding that vagueness, carelessness, and ambiguity do not constitute a knowing falsehood).

144. *See* Wines v. Wines (*In re* Wines), 997 F.2d 852, 856 (11th Cir. 1993); United States v. Sumpter (*In re* Sumpter), 136 B.R. 690, 700 (Bankr. E.D. Mich. 1991). There are two reasons why undervaluations generally do not constitute knowing misrepresentations. First, issues of value are thought to be matters of personal opinion, rather than precise calculations. *See In re* Sumpter, 136 B.R. at 696. Second, once an asset has been disclosed, courts reason that the trustee is on notice that the asset exists and can challenge its value in the context of objections to the debtor's exemptions. *See In re* Wines, 997 F.2d at 856.

discharge may not be denied where the debtor merely misunderstood the words contained in the bankruptcy disclosure documents.[145] These statements are all true for the same reason: without fraudulent intent, there can be no denial of a discharge under § 727(a)(4).

Moreover, under the statutory language, the knowingly false and material statement or omission must take place "in or in connection with the case."[146] A false statement made prior to petition does not warrant denial of a discharge, yet complaints based on this ground are filed.[147]

One might be tempted to ask at this point, "So what?" People engage in enough meritless forms of litigation to make the whole subject rather unremarkable.[148] More to the point, there are also many other grounds for objection to a general discharge,[149] and one could ask why this one is subject to any more abuse than the others. Here, however, the potential for abuse is unique. This objection is the only ground from which criminal charges may result.[150] A debtor who violates § 727(a)(4) not only may be denied a discharge, but also may be subject to imprisonment for committing the bankruptcy crime of false oath.[151] The very possibility of imprisonment modifies the parties' bargaining positions in a way that the other objections to

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145. *See, e.g.*, Fahey Banking Co. v. Irey (*In re* Irey), 172 B.R. 23, 27 (Bankr. N.D. Ohio 1994) (noting that debtor failed to disclose payment on loan to father because she did not understand the meaning of the word "insider"); *In re* Sumpter, 136 B.R. at 699 (noting that wife failed to understand who owned certain assets and had no knowledge of transfer of other assets jointly owned with her husband).

146. 11 U.S.C. § 727(a)(4).

147. *See In re* Sumpter, 136 B.R. at 700 (considering case in which creditors tried to use inconsistent values on pre-petition financial statements to show incorrect values on schedules, without presenting any proof that schedules were incorrect).

148. That parties take unmeritorious positions in litigation has been seen as anything but unimportant. The prevailing rule with respect to counsel fees in this country is aptly named the American rule and provides that each party pay his or her own attorney's fees, regardless of who prevails in the litigation. *See* M. Isabel Medina, Comment, *Award of Attorney Fees in Bad Faith Breaches of Contract in Louisiana—An Argument Against the American Rule*, 61 TUL. L. REV. 1173, 1175-76 (1987). Many commentators have argued that a shift away from the American rule with respect to fees could improve the court system and provide more equal access to the courts. *See, e.g.*, Albert A. Ehrenzweig, *Reimbursement of Counsel Fees and the Great Society*, 54 CAL. L. REV. 792, 794-800 (1966) (arguing that the administration of justice requires awarding attorney's fees to the prevailing party); Calvin A. Kuenzel, *The Attorney's Fee: Why Not a Cost of Litigation?*, 49 IOWA L. REV. 75, 78-86 (1963) (stating that attorney's fees awards could alleviate congestion in the courts).

149. *See* 11 U.S.C. § 727(a).

150. *See* 18 U.S.C. § 152 (1994).

151. *See id.*

discharge do not.[152] This possibility, combined with the typical consumer debtor's inability to afford effective counsel in defending such suits, provides unequaled incentive for debtors to settle these suits.

As psychological studies show, individuals who rarely are involved in litigation are more likely to be risk-averse and cooperative.[153] Conversely, institutional creditors—with more regular legal representation, more experience in litigation of a particular kind, and more ability to afford legal services—are more likely to present a combative rather than cooperative image in litigation.[154] This image may permit creditors to obtain more and higher settlement opportunities, even in unmeritorious suits. Under these circumstances, particularly given the threat of imprisonment, creditors have no reason not to bring claims with very little prospect of success.

Under the American rule governing attorney fees, each party pays its own attorney's fees, rather than shifting the fees to the loser or having them paid from an outside source.[155] In situations in which

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152. Naturally, the fear of imprisonment will reduce feelings of well-being and cause some people to lose self-esteem. Individuals who have low self-esteem are more risk-averse and more likely to settle than those with high self-esteem. *See* Robert A. Josephs, *Protecting the Self from the Negative Consequences of Risky Decisions*, 62 J. PERSONALITY & SOC. PSYCHOL. 26, 33 (1992).

153. *See* Galanter, *supra* note 1, at 99-100; *see also* Joel Brockner, *Self-Esteem and Reactions to Negative Feedback: Toward Greater Generalizability*, 21 J. RES. PERSONALITY 318, 328 (1987) (reporting on study in which people with lower self-esteem were found to be more likely to give in to negotiations than those with higher self-esteem); Josephs, *supra* note 152, at 26-28 (concluding that people with low self-esteem have trouble facing the threat of a failed decision and thus do what is necessary to avoid the possibility of regret). People who have been unsuccessful financially have reason to lack self-esteem and, like personal injury claimants, can be expected to be more risk-averse. *See* Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319, 349 (1991) (stating that a recent serious loss or injury makes personal injury claimants more risk-averse).

154. *See* HAZEL G. GENN, HARD BARGAINING OUT OF COURT SETTLEMENT IN PERSONAL INJURY ACTIONS 25-26 (1987) (discussing the English legal system in the context of tort suits and using Professor Galanter's analogies to "one shot players" and "repeat players").

155. The rule's name is derived from its distinct departure from the English rule, which generally shifts fees to the unsuccessful litigant. *See* Medina, *supra* note 148, at 1175-76. The rationale behind the English rule is that vindicated parties should be fully compensated for all injuries approximately caused by the opposing party's misconduct and that attorney fees are part of those injuries. *See id.* The rule also recognizes a need to punish frivolous litigation efforts. *See* Phyllis A. Monroe, Comment, *Financial Barriers to Litigation: Attorney Fees and the Problem of Legal Access*, 46 ALB. L. REV. 148, 151 (1981). Reacting adversely to all things English, early American colonists were quick to

bargaining power is uneven, Congress has made exceptions to the American rule with respect to attorney fees and has imposed statutory fees upon a party who institutes unmeritorious litigation or takes an unsupported position in litigation.[156] Fee shifting statutes, though not without criticism,[157] can compensate injured parties, provide equal access to the courts, and discourage and punish misconduct in litigation.[158] More importantly, fee shifting can encourage a more economically effective judicial system by inducing parties to conduct litigation more efficiently.[159]

Statutory fees are not imposed on a creditor who brings an unsuccessful complaint objecting to a debtor's general discharge, despite that the very filing of such a complaint effectively denies a debtor discharge of any of his or her debts until the complaint has been heard. This constitutes an unfair denial of the fresh start proscribed by the Bankruptcy Code.[160] The debtor in this situation

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reject the English rule in favor of the individualistic "folk hero" image reflected in the American rule. *See* Medina, *supra* note 148, at 1175-76. The American rule was thought to remove impediments to litigation and to place parties on equal footing by making both bear their own costs. *See id.* at 1176. Eventually, the American rule was adopted by the Supreme Court and became fully entrenched in the American legal system. *See id.* at 1176-77. The American rule became so entrenched that exceptions to it were recognized only in order to encourage private prosecution of certain cases or when the inequities of the rule proved too great. *See id.*

156. *See* Keith N. Hylton, *Fee Shifting and Incentives to Comply with the Law*, 46 VAND. L. REV. 1069, 1109 (1993).

157. *See generally* Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651, 653-66 (discussing various justifications for and criticisms of fee shifting).

158. *See* Hylton, *supra* note 156, at 1071 (noting that litigation costs are a significant obstacle to instituting lawsuits and that fee shifting in favor of prevailing plaintiffs discourages the greatest number of lawsuits); Monroe, *supra* note 155, at 151 (discussing the need to punish frivolous litigation efforts).

159. *See Foreword to Symposium on Civil Justice Reform*, 42 AM. U. L. REV. 1245, 1253-54 (1993); Hylton, *supra* note 156, at 1097-99.

160. *See In re* Burkhart, 91 B.R. 587, 589 (Bankr. W.D. Okla. 1988). According to the *Burkhart* court, creditors frequently file complaints under § 727 with no legal support whatsoever. As the court noted:

> Such a prayer for relief, even though without any argueable [sic] basis in fact or law, has the effect of denying debtor a discharge as to *any* of his debts until such time as the complaint is amended or adjudicated, and constitutes an unjustified denial to debtor of a timely "fresh start." Bankruptcy Rule 4004(c) was designed to insure to debtors this basic concept of bankruptcy policy, and its purpose is frustrated by these "scatter-gun" complaints.
>
> Creditors and their counsel instituting actions requesting the denial to debtor of any discharge under § 727, without any legal or factual basis for such request, should be cognizant of the provisions of Bankruptcy Rule 9011 and the penalties and sanctions which may, and in some instances must, be imposed for violations of that rule.

Id. However, as discussed in Section VII *infra*, Rule 9011 does not sufficiently address

also faces a negotiation that violates the spirit of the fresh start and that should never occur in the first place. This is a situation that Congress can and should rectify.

B. Objections to Discharge of Particular Debt Under Section 523(a)(2)

Because Congress chose to impose fees against creditors who bring unsuccessful objections to the discharge of a particular debt, analyzing the provisions that so provide may help establish a standard for imposing sanctions under § 727(a)(4). Adding such a provision to § 727(a)(4) would properly sanction creditors who bring unsuccessful objections to a debtor's general discharge. Section 523(a)(2), which describes particular debts that are excepted from a debtor's general discharge, states that pre-petition debts obtained by false pretenses, a false representation, or actual fraud, as described in § 523(a)(2)(A), and pre-petition debts obtained through the use of a false financial statement as described in § 523(a)(2)(B), are excepted from discharge.[161] Thus, § 523(a)(2)(A) is known as the exception for debts induced through "actual fraud," and § 523(a)(2)(B) is known as the exception for debts induced through a false financial statement.[162]

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this problem. *See infra* notes 240-68 and accompanying text (discussing application of Rule 9011 in this context).

161. *See* 11 U.S.C. § 523(a) (1994). Section 523(a) states in pertinent part:

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

Id.

162. Section 523(a) applies only to consumer debts. *See id.* Thus, a debtor who successfully defended a nondischargeability action relating to a loan used for stock market investments, for example, could not collect fees under this section. *See, e.g.*, Citizens Nat'l Bank v. Burns (*In re* Burns), 894 F.2d 361, 363 (10th Cir. 1990); Holmes v. Bulei, No. 94-15735DAS, 1995 WL 431297, at *10 (Bankr. E.D. Pa. July 20, 1995). A mortgage, on the other hand, does constitute consumer debt. *See* Guaranty Sav. & Loan Ass'n v. Lowe (*In re* Lowe), 109 B.R. 698, 699 (W.D. Va. 1990).

1. The Perception of Potential Abuse Under Section 523(a)(2)

The pre-Code Bankruptcy Act provided that if a debtor obtained pre-petition credit through fraud, or provided a creditor with a false financial statement upon which the creditor relied in granting credit to the debtor, a debtor's general discharge would be denied.[163] Evidence presented to Congress at the time the Bankruptcy Code of 1978 was enacted, however, indicated that creditors were abusing the "false financial statement" exception.[164] Creditors maintained control over the information that was provided on financial statements, and creditors purportedly informed debtors that despite language on the financial forms stating that "these are all of my debts," they need not list all debts.[165] The forms also were too small to contain a complete list of all debts, making it possible for creditors to claim later that the forms contained false or incomplete information.[166]

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163. *See* H.R. REP. NO. 95-595, at 130 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6091.

164. *See id.*

165. *See id.* According to the legislative history, it was

> a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding. While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.
>
> However, the creditor often has other sources of information, such as credit bureau reports, to verify the accuracy of the list of debts. Nevertheless, if the debtor files bankruptcy, creditors with these financial statements are in a position to threaten the debtor with litigation to determine the dischargeability of the debt, based on the false financial statement exception to discharge. Most often, there has been no intent to deceive on the part of the debtor, and, as in so many aspects of the creditor-debtor relationship, the debtor has simply followed the creditor's instructions with little understanding of the consequences of his action.

Id. at 130-31, *reprinted in* 1978 U.S.C.C.A.N. at 6091-92.

166. *See id.* In my own practice, I became aware that to this day, mortgage bankers still inform debtors to value their personal property at 30% of the mortgage amount in order to prove sufficient assets to qualify for the home, even though few debtors have personal property that is this valuable. If a creditor brought an action on this basis, like one of the creditors in the hypothetical, it is unlikely that it could prove it actually relied on this statement, as required by § 523(a)(2)(B). Many debtors do not know the law, however, and might settle based on the sizable discrepancy in asset valuation between the pre-petition financial statement and the bankruptcy petition.

2. The Imposition of Sanctions Under Section 523(d) and the Section's Underlying Policies

In light of these abuses, some Bankruptcy Code drafters believed that the entire "false financial statement" exception should be eliminated; others thought the exception should merely be tempered.[167] Consequently, under § 523(a)(2)(B) of the Bankruptcy Code of 1978, a creditor could have only its individual debt excepted from discharge for making a false financial statement, and, even then, only if the statement was material and was relied upon by the creditor in its credit decision.[168] In contrast, a debtor's general discharge under § 727 cannot be denied as a result of the presentation of a false financial statement.[169]

To further discourage creditors from using § 523(a)(2) in an abusive fashion, Congress enacted § 523(d), which states that

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fees for the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.[170]

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167. *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. REP. NO. 93-137, pt. 1, at 176, pt. 2, at 136 (1973).

168. *See* Pub. L. No. 95-598, § 523(a)(2), 92 Stat. 2549 (1978) (current version at 11 U.S.C. § 523(a)(2) (1994)).

169. *Compare* 11 U.S.C. § 523(a)(2) (providing that a debt may be excepted from discharge if the debtor obtains credit through the presentation of a false financial statement), *with id.* § 727 (containing no provision for denial of a general discharge as a result of presentation of a false financial statement).

170. *Id.* § 523(d). In contrast, under the Act of 1978, the bankruptcy court was not expressly authorized to grant fees against a creditor who brought an unsuccessful dischargeability action. *Compare* Grove v. Fulwiler (*In re* Fulwiler), 624 F.2d 908, 910 (9th Cir. 1980) (refusing to grant fees in such an action, pursuant to the American rule, because the creditor's act was not brought in bad faith or to harass the debtor and because, under the law applicable to this case, there was no other basis on which to award such fees), *with* American Sav. Bank v. Harvey (*In re* Harvey), 172 B.R. 314, 318 (B.A.P. 9th Cir. 1994) (acknowledging that fees were now appropriately granted against a creditor in a losing case, regardless of bad faith, based upon § 523(d)).

It is unclear why Congress chose to sanction abuses under § 523(a)(2) but not under § 727. The legislative history indicates that there was more perceived abuse under § 523(a)(2) at the time the Bankruptcy Code was proposed. *See* H.R. REP. NO. 95-595, at 365 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6321. In addition, abuse under § 727 may be easier to hide from courts and legislatures, given the imbalance of power between the parties. *See supra* notes 36, 150-54 and accompanying text.

The section was enacted to dissuade creditors from initiating complaints based on false financial statement objections in hopes of obtaining a settlement from an honest debtor who was trying to save attorney fees.[171] The original version of the section, however, made no reference to substantial justification and essentially required the court to impose sanctions if the creditors' suit was unsuccessful.[172]

Section 523(d), in both its prior and current form, creates a presumption in favor of granting such fees in a losing case under § 523(a)(2).[173] The justification for this divergence from the American rule was that unless creditors could be discouraged from abuse, even creditors with weak cases could use their greater leverage and resources to obtain payment of their otherwise dischargeable

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171. *See* H.R. REP. NO. 95-595, at 365 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6321; Manufacturers Hanover Trust Co. v. Hudgins, 72 B.R. 214, 219 (N.D. Ill. 1987).

172. Under the 1978 version of § 523(d), an award of attorney fees to the prevailing consumer debtor was mandatory absent a finding of clear inequity. *See* Thorp Credit, Inc. v. Carmen, 723 F.2d 16, 17-18 (6th Cir. 1983). The Consumer Credit Amendments to the Bankruptcy Code, however, enacted a new formula as part of BAFJA. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 352 (1984) (codified as amended at 11 U.S.C. § 151). The old version of § 523(d) provided that:

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

Pub. L. No. 95-598, § 523(d), 92 Stat. 2549, 2592 (1978), *amended by* 11 U.S.C. § 523(d) (1994).

173. *See* 11 U.S.C. § 523(d). Under the current version of the statute, once the debtor has won his case, the court is still free to find that the request for nondischargeability was "not substantially justified" or that awarding attorney fees would be "unjust." 11 U.S.C. § 523(d); *see also* Firstbanks v. Goss (*In re* Goss), 149 B.R. 460, 462-63 (Bankr. E.D. Mich. 1992) (noting the effect of the change in statutory language). This was not the case under the original version of § 523(d), which was more liberal to debtors because it did not include any reference to justification or special circumstances. *See* Pub. L. No. 95-598, § 523(d), 92 Stat. 2549, 2592 (1978), *amended by* 11 U.S.C. § 523(d). The change of language has increased the court's discretion to deny an award of attorney fees. *See* Citizens Nat'l Bank v. Burns, 77 B.R. 822, 823 (D. Colo. 1987), *aff'd*, 894 F.2d 361 (10th Cir. 1990); Household Fin. Corp. v. Van Buren (*In re* Van Buren), 66 B.R. 422, 424 (Bankr. S.D. Ohio 1986). Thus, consideration of the specific facts of the case is now necessary to determine the existence or absence of special circumstances.

Under the present version, however, it is clearly the creditor's burden to show that special circumstances exist that would make the award unjust, or to show that the relief requested was substantially justified under the particular facts of the case. *See* FCC Nat'l Bank v. Dobbins, 151 B.R. 509, 511 (W.D. Mo. 1992); *In re* Goss, 149 B.R. at 461-62; Mid-America Credit Union v. Glazier (*In re* Glazier), No. 90-1256-C, 1991 WL 177698, at *6 (D. Kan. Aug. 26, 1991); Chevy Chase Fed. Sav. Bank v. Weinand (*In re* Weinand), No. 4-90-1182, 1991 WL 799, at *3 (Bankr. D. Minn. Jan. 7, 1991); Commercial Credit Plan v. Carter (*In re* Carter), 101 B.R. 702, 705 (Bankr. E.D. Okla. 1989); Chrysler First Fin. Serv. Corp. v. Rhodes (*In re* Rhodes), 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988).

debts.[174] This abuse would unjustifiably interfere with the debtor's fresh start.[175]

Under § 523(d), fees can be shifted only to a creditor, not to the debtor, after an unsuccessful result.[176] Making the imposition of fees a one-way street also was considered necessary in order to balance the power between the parties.[177] If a debtor thought that she might have to pay a creditor's attorney fees, which could be even more expensive than her own lawyer's fees, then she would again feel the need to settle even largely unmeritorious dischargeability actions.[178] She could not afford to take a chance. Thus, the legislative history of the section acknowledges creditors' greater bargaining power in litigation, in the context of non-dischargeability for fraud.[179]

3. Defining the Sanctions Standard Contained in Section 523(d)

While the initial sanctions legislation imposed fees as a matter of course in unsuccessful actions brought under § 523(a)(2), the current sanction language is equivocal. According to the section as it now reads, the court "shall grant judgment in favor of the debtor" for such fees "if the court finds that the position of the creditors was not substantially justified," unless "special circumstances would make the award unjust."[180]

The legislative history of these amendments to § 523(d) shows a desire to balance the debtor's right to be free from unreasonable

174. *See Citizens Nat'l Bank*, 77 B.R. at 823 n.1.

175. *See* ITT Fin. Servs. v. Woods (*In re* Woods), 69 B.R. 999, 1000 (Bankr. E.D. Pa. 1987) ("The language and spirit of section 523(d) codifies a policy of discouraging creditors from objecting to the dischargeability of consumer debts in marginal cases or where substantial justification [for the relief requested] does not exist."). The threat of litigation alone is often enough to coerce a debtor to settle or make payment in a reduced amount when the debt would otherwise simply be discharged. "[D]ebtors are frequently unable to afford counsel to defend such cases, and, therefore, it is important that debtor's counsel receive some monetary incentive" to take on such a representation. *Id.*

176. *See* 11 U.S.C. § 523(d).

177. *See* H.R. REP. NO. 95-595, at 131 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6092. Though shifting fees to the debtor upon loss might seem fair at first blush, such a provision would alter the balance of power in favor of the creditor by inducing debtors to settle regardless of the merits of their case. Furthermore, the creditors' fees could be higher than the debtor's fees, creating greater disincentive to settle. *See id.*

178. Congress counterbalanced creditors' self-styled advantage by mandating a fee award to a prevailing debtor, even if the creditor's claim was brought in good faith. *See* First Serv. Corp. v. Schlickmann (*In re* Schlickmann), 7 B.R. 139, 141 (Bankr. D. Mass. 1980). Congress thus intended for § 523(d) to ensure that debtors who have dealt honestly with creditors receive the fresh start that is at the heart of the Bankruptcy Code.

179. *See* H.R. REP. NO. 95-595, at 130-31, *reprinted in* 1978 U.S.C.C.A.N. at 6091-93.

180. 11 U.S.C. § 523(d).

challenges with the creditor's need to raise reasonable challenges.[181] The language of the amendment was taken primarily from the Equal Access to Justice Act ("EAJA"),[182] which prescribes the statutory basis on which citizens may receive attorney fees when the federal government takes an unjustified position in litigation.[183]

Due to this incorporation of language from the EAJA, bankruptcy courts have analyzed cases decided under the EAJA to interpret the meaning of § 523(d).[184] Much of the analysis has focused on the leading Supreme Court case on the EAJA, *Pierce v. Underwood.*[185] In *Pierce*, the Secretary of Housing and Urban Development had failed to implement a federally funded subsidy program that would pay owners of government-subsidized apartments subsidies to defray rising utility costs and property taxes.[186] The Secretary was sued by injured homeowners in nine federal courts, and all of the homeowners ultimately prevailed against the government.[187] Under the EAJA, the homeowners were entitled to an award for attorney fees unless the government's

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181. *See* OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983, S. REP. NO. 98-65, at 9-10 (1983). Congress borrowed language from the Equal Access To Justice Act, 28 U.S.C. § 2412(d)(1)(A) (1994), in establishing the fee standard under the revised § 523(d):

> The Committee, after due consideration, has concluded that amendment of this provision to incorporate the standard for award of attorney's fees contained in the Equal Access to Justice Act strikes the appropriate balance between protecting the debtor from unreasonable challenges to dischargeability of debts and not deterring creditors from making challenges when it is reasonable to do so.

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983, S. REP. NO. 98-65, at 9-10 (1983).

182. 28 U.S.C. § 2412(d)(1)(A) (1994).

183. *See* 11 U.S.C. § 523(d). Section 523(d) mirrors the language of the EAJA, which governs claims for attorney fees by litigants against the federal government and which states:

> Except as otherwise specifically provided by statute, a court shall award to a prevailing party other than the United States fees and other expenses, in addition to any costs awarded pursuant to subsection (a), incurred by that party in any civil action (other than cases sounding in tort), including proceedings for judicial review of agency action, brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

28 U.S.C. § 2412(d)(1)(A).

184. *See, e.g.*, *In re* Hingson, 954 F.2d 428, 429-30 (7th Cir. 1992); Carthage Bank v. Kirkland, 121 B.R. 496, 499-500 (S.D. Miss. 1990); America First Credit Union v. Shaw (*In re* Shaw), 114 B.R. 291, 294-95 (Bankr. D. Utah 1990).

185. 487 U.S. 552 (1988).

186. *See id.* at 555.

187. *See id.*

behavior in the suit was substantially justified.[188] The government argued that its behavior was substantially justified because the program's implementation language was permissive rather than mandatory.[189] The Court, however, found no support for this position.[190] According to the Supreme Court, the phrase "substantially justified" was added to the EAJA to ensure that the government's positions were reasonable both in law and fact.[191] Rejecting arguments by homeowners that the test should be more stringent than mere reasonableness, the Court held that there is simply no stopping ground between "reasonable" and the far too stringent standard of "clearly and convincingly justified."[192] In the face of strong language appearing to mandate that it implement the program, as well as many adverse rulings against the government at the time that it opposed this particular suit, the Court ruled in the homeowners' favor, holding that the government's position was not substantially justified.[193]

Bankruptcy courts have attempted to force the reasoning in *Pierce* into the bankruptcy context required by § 523(d), but only with moderate success. Despite its origins, courts have recognized that § 523(d) must be interpreted in light of its own legislative history (or that of its predecessor statute) and read to discourage frivolous creditor claims.[194] Section 523(d) and the EAJA also have very different purposes. The government is funded through taxpayers, and courts are not likely to charge taxpayers for another lawyer's fees unless the government's behavior is more than meritless.[195] Thus,

188. *See* 28 U.S.C. § 2412(d)(1)(A).

189. *See Pierce*, 487 U.S. at 569.

190. *See id.* at 570-71.

191. *See id.* at 565. After considering endless viable interpretations of the phrase, the Court concluded that it meant "justifiable in substance or in the main," as compared to "justified to a high degree." *Id.* The Court equated this interpretation with "reasonable both in law and in fact." *Id.*

192. *Id.* at 568; *see also* Armstead v. United States Dep't of Hous. & Urban Dev. (*In re* Armstead), 106 B.R. 405, 413-17 (Bankr. E.D. Pa. 1989) (discussing *Pierce*, 487 U.S. at 552, and *Brinker v. Guiffrida*, 798 F.2d 661, 664 (3d Cir. 1986)). The *Brinker* court enumerated three criteria to establish substantial justification: (1) a reasonable basis in truth for the facts alleged; (2) a reasonable basis in law for the theory propounded; and (3) reasonable support in the facts alleged for the legal theory advanced. *See Brinker*, 798 F.2d at 664.

193. *See Pierce*, 487 U.S. at 570-71.

194. *See* H.R. REP. NO. 95-595, at 130-31, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6091-93.

195. *See, e.g.*, Carthage Bank v. Kirkland (*In re* Kirkland), 121 B.R. 496, 498 (Bankr. S.D. Miss. 1990). Moreover, unlike § 523(d), fees are available under the EAJA even if the government is the defendant. *See* 28 U.S.C. § 2412(d)(1)(A) (1994) (stating that fees

what is considered "substantially justified" for the federal government, a publicly funded and ordinarily understaffed entity, might be quite different from what is substantially justified for a private creditor trying to collect a debt after bankruptcy. Accordingly, it is not at all clear what "substantially justified" means in the context of § 523(d).

The other factual limitation contained in § 523(d), that "special circumstances" exist that would make the award of fees unjust, is no more clear. Although this language appeared in the original version of § 523(d), which was not based on the EAJA at all, courts still look to the EAJA to ascertain what such circumstances might be.[196] The EAJA's legislative history indicates that the purpose of this "safety valve" in the EAJA is to ensure that "the Government is not deterred from advancing in good faith the novel but credible extensions and interpretations of the law."[197] This language, however, gives the court the discretion to deny awards on virtually any basis.[198] Bankruptcy courts have recognized that the substantial justification standard must be applied in the context of the purpose of § 523(d), which is to protect debtors from unsavory litigation tactics.[199] Thus, a completely open-ended test, under which any behavior is justified, would defeat the purpose of the statute.[200]

Circumstances that have been found not to be special enough to justify denial of the imposition of fees include that a § 341 hearing[201]

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may be imposed against the government under the section in any case "by or against the United States").

196. *See, e.g.*, *In re* Kirkland, 121 B.R. at 499.

197. EQUAL ACCESS TO JUSTICE ACT, H.R. REP. NO. 96-1418, at 11 (1980), *reprinted in* 1980 U.S.C.C.A.N. 4984, 4990. This safety valve was considered necessary to ensure the government's "vigorous enforcement efforts." *Id.*

198. *See* Oguachuba v. Immigration & Naturalization Serv., 706 F.2d 93, 98-99 (2d Cir. 1983) ("The EAJA thus explicitly directs a court to apply traditional equitable principles in ruling upon an application for counsel fees . . . ."); Abela v. Gustafson, 888 F.2d 1258, 1266 (9th Cir. 1989); Louisiana *ex rel.* Guste v. Lee, 853 F.2d 1219, 1224 (5th Cir. 1988).

199. *See, e.g.*, *In re* Kirkland, 121 B.R. at 500 (stating that the language in § 523(d) must be tempered by its stated goal of deterring creditors from filing unwarranted objections to discharge).

200. With a standard as broad as equity, it is hard to establish a meaningful test. Courts interpreting the EAJA have held that if a claimant undertook affirmative activity that took advantage of the very government activity he later challenged, then granting fees would be unjustified. *See* Taylor v. United States, 815 F.2d 249, 253 (3d Cir. 1987); *Oguachuba*, 706 F.2d at 99. However, use of this type of test under Bankruptcy Code § 523(b) has been unsuccessful. *See* 11 U.S.C. § 523(b) (1994); *In re* Kirkland, 121 B.R. at 501 (refusing to uphold a bankruptcy court decision denying fees under the "affirmative activity" test).

201. A § 341 hearing is a meeting conducted by the bankruptcy trustee, at which creditors may ask the debtor questions about her assets, her business practices, and her

was too short,[202] that the debtor resisted appearing at a § 341 hearing,[203] that the debtor gave vague and evasive answers at a § 341 hearing,[204] and that the debtor took action that was purportedly disadvantageous, though not fraudulent, toward the creditor.[205] Neither good faith on the part of the creditor in granting credit nor an ability of the debtor to pay back the creditor constitutes a special circumstance.[206] Finally, a hostile attitude toward the creditor does not constitute a special circumstance because ultimately it is the conduct of the creditor, not the debtor, that determines whether special circumstances are present.[207]

In sum, § 523(d) mandates the imposition of sanctions whenever the creditor brings an unsuccessful action, without being substantially justified, unless the imposition of fees would be unjust based upon the creditor's behavior. While the section does not mandate the imposition of fees in every instance, the creditor has the burden of proving that its behavior falls within one of these safety valves, once the relief requested in its complaint has been denied. Though somewhat vague and subjective, the provision presumably serves its purpose of discouraging frivolous discharge objections in the very limited context of § 523(a)(2)(A). Thus, this Article will look initially to this section in attempting to develop a sanctions standard under § 727(a).

C. Comparing the Fraud-Based Limitations and Objections to Discharge

As the statutory provisions discussed above provide, only a few of the limitations and objections to discharge are based upon a form of fraud. Of those that are, one, § 523(a)(2), pertains to pre-petition fraud in the inducement,[208] while another, § 727(a)(4), pertains to

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case. *See* 11 U.S.C. § 341.

202. *See In re* Kirkland, 121 B.R. at 501.

203. *See id.*

204. *See id.*

205. *See id.* at 502.

206. *See id.*

207. *See id.* The *Kirkland* court concluded that

> the focus of any analysis undertaken pursuant to section 523(d) should be on the creditor, since the primary purpose of that provision is to act as a deterrent to unjustifiable creditor conduct. This Court is also persuaded that the application of equitable principles in a section 523(d) matter must be made with this purpose in mind.

Id. at 503-04.

208. *See* 11 U.S.C. § 523(a)(2) (1994) (denying dischargeability of particular pre-petition debts induced by actual fraud or through presentation of a false financial

false statements made in a debtor's bankruptcy papers.[209] Commentators typically refer to § 523(a)(2) as "the" fraud exception to discharge, and most scholarly analyses of limitations on discharge based on fraud focus on potential abuse under § 523, not § 727.[210] Under § 727, however, the standards for denial of a general discharge are extremely vague, far more so than those applied in § 523(a)(2) cases.[211] Moreover, the stakes for the debtor are far higher in objections to a general discharge under § 727, making this a fertile area for creditor abuse.[212] Thus, it is surprising that so little attention has been paid to this issue.

Perhaps the reason few commentators write about § 727 is that requests for relief under this section are considered drastic and thought to be rarely utilized. Reported cases indicate, however, that § 727 is hardly underutilized.[213] Given the number of unsuccessful cases reported, this may be one of the most abused sections of the Bankruptcy Code.

A creditor who brings an unsuccessful challenge to the dischargeability of an individual debt under § 523(a)(2) may be charged with the debtor's attorney's fees by statute, while the creditor bringing an unsuccessful objection to a debtor's general discharge under § 727(a)(4) cannot.[214] The attorney fees provision in § 523(d) applies to both subsections (A) and (B) of § 523(a)(2)—in other words, to both "actual fraud" and fraud based on false financial statements,[215] even though the legislative history explains inclusion of

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statement).

209. *See id.* § 727(a)(4) (denying discharge of all debts if the debtor knowingly and fraudulently makes a false statement in or in connection with her case).

210. *See, e.g.*, Barry L. Zaretsky, *The Fraud Exception to Discharge Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 253 (1979); Zeigler, *supra* note 91, at 896-98.

211. To prove fraud under § 727(a)(4)(A), one must prove common-law fraud, which is an extremely difficult task. *See* MacLeod v. Arcuri (*In re* Arcuri), 116 B.R. 873, 880 (Bankr. S.D.N.Y. 1990).

212. There are also a number of ways for a creditor to allege fraud. Moreover, a debtor may find it difficult to respond to the creditor's allegations, unless those allegations are very specific. By comparison, since the requirements for proving § 523(a)(2) are so specifically delineated, it is far easier for a debtor to respond to allegations and thus far harder for a creditor to abuse the section. *See* 11 U.S.C. § 523(a)(2).

213. A review of the most recent *West's Bankruptcy Digest* pocket part indicates that a great number of cases are brought based on illegitimate grounds. *See* 16 WEST'S BANKRUPTCY DIGEST ¶¶ 3283-84 (West 1989 & Supp. 1997). Moreover, these reported cases do not reflect the number of cases that are settled by debtors before they become reported cases.

214. *See In re* Burkhardt, 91 B.R. 587, 589 (Bankr. W.D. Okla. 1988).

215. *See* Citizens Nat'l Bank v. Burns (*In re* Burns), 894 F.2d 361, 363 (10th Cir. 1990); Manufacturer's Hanover Bank Trust Co. v. Cordova (*In re* Cordova), 153 B.R. 352, 357

this provision in the context of the false financial statement exception only.[216] In fact, commentators and legislative history discuss the imposition of sanctions only in the context of false financial statements, as if § 523(d) does not apply to actual fraud cases.[217]

Yet § 523(d) is clear on its face. The grant of attorney fees applies to all § 523(a)(2) cases, including "actual fraud" cases.[218] There appears to be no basis at all for imposing statutory fees in a discharge complaint based upon pre-petition fraud that would not apply with equal force to complaints based upon allegations of post-petition fraud. Thus, there is no reason not to impose the same, if not stronger, statutory sanctions in unsuccessful § 727 complaints based on fraud. In fact, while § 523(d) may well have deterred creditors from bringing nondischargeability complaints under § 523(a)(2), it may simply have moved discharge litigation to another battlefield, specifically to the sphere of § 727.

VI. FORMULATING A SANCTIONS POLICY FOR UNSUCCESSFUL SECTION 727(A)(4) COMPLAINTS

A creditor who unsuccessfully objects to the discharge of its particular debt on the basis of fraud must ordinarily pay the debtor's attorney's fees.[219] This provision was added to the statute by Congress to thwart creditor abuses and to balance the power between potential litigants in this particular circumstance.[220] In comparison, there currently is no statutory basis for imposing attorney fees upon a creditor who brings an unsuccessful complaint to deny a general discharge based on post-petition fraud.[221] The harm caused by a creditor who unsuccessfully objects to a debtor's general discharge, however, can be far greater than that caused by a creditor who objects to the discharge of an individual debt.[222]

In order to preclude creditors from engaging in leverage litigation under § 727 solely to force an improper settlement of a pre-petition debt, § 727 should be amended to provide for the imposition

(Bankr. M.D. Fla. 1993).

216. *See* H.R. REP. NO. 95-595, at 130 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6090.

217. *See, e.g.*, Zeigler, *supra* note 91, at 891.

218. *See* 11 U.S.C. § 523(d) (1994).

219. *See id.*

220. *See supra* notes 165, 178 and accompanying text (discussing the need to balance the power between the debtor and creditors who might abuse § 523(a)(2)).

221. *See* 11 U.S.C. § 727.

222. *See supra* note 127 and accompanying text (discussing the implications of a successful action under § 727(a)).

of fee sanctions against creditors who bring unsuccessful complaints objecting to a debtor's general discharge based on fraud.[223]

A. *Adopting the Same Standard in Section 727 That Is Used in Section 523*

The primary purposes of § 727(a)(4) are to discourage post-petition fraud, to ensure full debtor disclosures to the greatest extent possible, and to punish failure to comply with these standards.[224] These deterrent goals are not present in § 523(a), which serves primarily a compensatory purpose.[225] If a creditor is harmed by an improper disclosure or fraud, it is compensated by having its debts excepted from discharge.[226] If a debtor is dishonest or incomplete in his disclosures, then his punishment is denial of his entire bankruptcy discharge.[227] The discharge of the objecting creditor's debt is secondary and unrelated to the particular fraud. While § 523(a)(2)(A) itself was drafted in a way that would discourage creditors from using the section at all, § 727(a)(4) serves a function that is arguably far more critical to bankruptcy policy.[228] Thus, some may argue that amending § 727 to provide for the imposition of fees would discourage creditor complaints that are legitimate and necessary to ensure honesty in the bankruptcy process. These differing policies do not, however, alter the need for creditor actions to be based upon well-founded facts.[229] Concerns about upsetting the deterrence value of § 727(a)(4) relate to the standard for relief under

223. *See infra* notes 240-68 and accompanying text (concluding that Bankruptcy Rule 9011 should be used as an interim solution to a § 727 amendment).

224. *See* Sperling v. Hoflund (*In re* Hoflund), 163 B.R. 879, 882 (Bankr. N.D. Fla. 1993) (stating that the purpose of § 727(a)(4) is not to punish debtors for honest mistakes, but for intentional attempts to withhold information); Tavormina v. Van Den Heuvel (*In re* Van Den Heuvel), 125 B.R. 846, 851 (Bankr. S.D. Fla. 1991) (stating that "[t]he purpose of § 727(a)(4)(B) is to prevent fraud"); Aubrey v. Thomas (*In re* Aubrey), 111 B.R. 268, 274 (B.A.P. 9th Cir. 1990) (stating that the purpose of § 727(a)(4) is to ensure disclosure of all relevant information).

225. The debtor is repaid for the fees she expended in defending against the creditors' unsuccessful complaint brought under § 523(a)(2). *See* 11 U.S.C. § 523(a)(2), (d). While the creditor is also punished, the primary goal is to compensate the debtor for the expense of hiring an attorney. *See In re* Kingsbury, 146 B.R. 581, 584 n.13 (Bankr. D. Me. 1992) (noting that for a debtor without funds, § 523(d) may provide the only available access to representation and thus a very important means of compensation).

226. *See* 11 U.S.C. § 727(a).

227. *See id.* § 727(a)(4).

228. *See supra* notes 130-32 and accompanying text.

229. As courts have noted, lawyers tend to "file first, think later." *See In re* TCI Ltd., 769 F.2d 441, 442 (7th Cir. 1985) (addressing the need to ensure that a complaint is well-grounded before it is filed).

§ 727, not the punishment imposed for improper litigation.

Whenever a severe imbalance of power exists, more leverage litigation occurs and harms the party with less leverage.[230] A solution to the problem is required. The challenge lies in adopting an appropriate standard for sanctions in deterring abusive creditor actions without minimizing the statute's deterrent effect upon debtors. The question, of course, is how best to formulate the appropriate standard for sanctioning unsuccessful § 727 complaints. The language of § 523(d) is highly equivocal and combines too many subjective standards.[231] Even so, it would be far easier legislatively to add the same language to § 727 than to propose something new, even if new language would be superior. If use of the same standard was all that could be accomplished, that result would be far better than no change in the statute.

Some might argue, however, that applying the existing test for imposition of sanctions is easier in the false financial statement context than in the context of false oaths, which can arise in a huge variety of contexts and which are more difficult to prove.[232] No doubt, in false financial statement cases, the standard for denial of discharge of a debt is fairly objective and legislatively clear.[233]

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230. *See, e.g.*, Transouth Fin. Corp. v. Johnson, 931 F.2d 1505, 1515 (11th Cir. 1991) (Clark, J., dissenting) (discussing leverage litigation in context of a creditor threatening a debtor with litigation if the debtor fails to reaffirm indebtedness); Chase Manhattan Bank v. Birkland, 98 B.R. 35, 36 (W.D. Wash. 1988) (same); Commercial Union Ins. Co. v. Sidore (*In re* Sidore), 41 B.R. 206, 208 (Bankr. W.D.N.Y. 1984) (same); *In re* Hinkle, 9 B.R. 283, 285 (Bankr. D. Md. 1981) (same).

231. *See supra* notes 180-207 and accompanying text.

232. Objections to a debtor's general discharge, brought under § 727(a)(4), can arise in many contexts because the alleged false oath can occur in connection with any aspect of the case. The alleged impropriety can involve a failure to disclose an asset or a transfer of property on the bankruptcy disclosure documents, *see* Davis v. Davenport (*In re* Davenport), 147 B.R. 172, 181 (Bankr. E.D. Mo. 1992), a failure to disclose certain debts, *see* Aubrey v. Thomas (*In re* Aubrey), 111 B.R. 268, 273 (B.A.P. 9th Cir. 1990), lying at a creditors' meeting, *see* Ohio Co. v. Maynard (*In re Maynard*), 162 B.R. 349, 355 (Bankr. M.D. Fla. 1993), or any other issues arising in or in connection with a case. The false financial statement exception contained in § 523(a)(2)(B) applies only in very limited factual circumstances. *See supra* note 161 (quoting the text of 11 U.S.C. § 523(a)(2)(B)).

233. Rather than being triggered by a false oath in the context of any aspect of an entire case, as § 727(a)(4) is, § 523(a)(2)(B) is extremely specific as to the circumstances under which a debt will be excepted. *See* 11 U.S.C. § 523(a)(2)(B). A debt will not be excepted from discharge unless a host of particular facts are present, including: (1) the debtor obtains credit, (2) through the use of a written statement, (3) that is materially false, (4) that relates to the debtor's financial condition, (5) that is relied upon by the creditor advancing the credit, and (6) that the debtor made with intent to deceive. *See id.* Congress made extremely clear what behavior it was attempting to deter in adopting § 523(d). *See supra* notes 163-72 and accompanying text.

According to the statute, a creditor must reasonably rely on the false statement, and the statement must be material in order to successfully except the debt from discharge.[234] With a standard of proof this strict, creditors are unlikely to regularly object on this basis, even without the sanctions provisions.

As stated above, however, § 523(d) applies not only to complaints based on false financial statements but also to those based on actual fraud.[235] And, under § 523(a)(2)(B)—the "actual fraud" basis for objecting to discharge—the standard is as subjective and open-ended as the § 727 standard. Thus, even if there were a basis for distinguishing false oath objections from false financial statement objections, there is no basis for distinguishing between the subjectivity contained in the false oath standard and that found in § 523(a)(2)(B) "actual fraud" cases. In fact, both of these impediments to full discharge require proof of actual fraud, the standard for which is identical in each case.[236] The only difference is that § 523(a)(2)(B) describes the consequences of pre-petition fraud, which, if proven, would lead to nondischargeability of a particular debt, and § 727(a)(4) describes the consequences of post-petition fraud, which, if proven, would lead to denial of a debtor's entire bankruptcy discharge and possibly imprisonment as well. Given the relative stakes, it makes little sense to sanction only the lesser of the two evils.

B. Adopting a More Particularized Standard

Despite these arguments, there may be legitimate reasons to apply a more specific sanctions standard to both § 727(a)(4) and § 523(a)(2) complaints than that contained in § 523(d). A more specific standard could provide particular guidance regarding what is "substantially justified" or what facts constitute "special circumstances that would make an award unjust," by tying creditor

234. *See* 11 U.S.C. § 523(a)(2)(B)(i), (iii).

235. *See supra* notes 215-18 and accompanying text.

236. The need to prove actual fraud is identical in each case, except that the circumstances under which fraud may be proven is more limited under § 727 because the fraud must occur "in or in connection with" the bankruptcy case itself. *See* 11 U.S.C. § 727(a)(4). However, § 523(a)(2)(A) applies to any pre-petition fraud, other than the presentation of a false financial statement. *See id.* § 523(a)(2)(A) (refusing to discharge pre-petition debts to the extent obtained by "false pretenses, a false representation, or actual fraud"). Thus, § 523(a)(2)(A) is actually broader and less specific than § 727. *Compare id.* § 727(a)(4) (punishing any fraud or false statement made in connection with the bankruptcy case), *with id.* § 523(a)(2)(A) (punishing any pre-petition fraud or false statement, made in any context, that results in the extension of credit).

actions to objective criteria. For example, a creditor's actions could be deemed per se sanctionable if the creditor did not produce evidence sufficient to reach a trial on the merits.[237] The imposition of sanctions based upon this particular standard would be very beneficial, though not without problems. One benefit of such a standard is that it would be entirely objective. If a creditor could not produce evidence sufficient to survive a motion to dismiss or a motion for summary judgment, then fees would be automatically imposed. There would be no questions about substantial justification or injustice and no subjective standard to apply. This result would assist courts in achieving the goal of deterring actions that undermine the fresh start doctrine.

This standard alone may not successfully deter frivolous actions. First, some courts may permit unworthy cases to go to trial in order to avoid the automatic imposition of sanctions. This result would actually cost deserving debtors more in attorney fees than they pay now, as more cases would reach trial. A highly objective standard also may permit too many frivolous cases to go unsanctioned by limiting sanctions to only a very limited number of cases. Because some courts let virtually all matters go to trial, this standard actually may be too limited to deter the vast majority of frivolous actions. Moreover, some creditors might claim to have pre-trial evidence that they never produce at trial, thus making a standard this narrow ineffective in such cases.

One way to address these issues would be to pass an amendment that not only makes sanctions mandatory if a creditor is unable to produce evidence sufficient to reach a trial on the merits, but that also contains a permissive provision that would allow the imposition of sanctions, even after trial, when the circumstances warrant such an imposition. The combination of these two tests would reach a sensible balance between debtor and creditor interests on this issue. Creditor groups surely will oppose any amendment that discourages the exercise of their right to object to a debtor's discharge. Yet debtors have a right to be free from threats that undermine the

237. Some courts have indirectly used the fact that a case never reached trial as support for imposing fees under Rule 9011 or § 523(d). *See In re* Hingson, 954 F.2d 428, 429 (7th Cir. 1992); Ciancioso v. Ciancioso (*In re* Ciancioso), 187 B.R. 438, 442-43 (E.D.N.Y. 1995). Another recognized indicium of a meritorious claim is the willingness of the debtor to settle. *See* In re *Hingson*, 954 F.2d at 429. For the reasons stated in this Article, the tendency to settle in the context of discharge litigation *does not* provide evidence of a meritorious claim. Rather, it reflects the parties' bargaining power and their ability to handle, assess, and afford risk, both financial and otherwise. *See supra* notes 148-54, 175 and accompanying text.

bankruptcy discharge,[238] particularly from creditors who have enormous leverage over them and particularly when the threats can include threats of imprisonment, a threat far more serious than nondischargeability of indebtedness.[239]

VII. APPLYING BANKRUPTCY RULE 9011 PENDING LEGISLATIVE AMENDMENTS

Bankruptcy Rule 9011[240] imposes sanctions in bankruptcy matters that are similar to those imposed under Rule 11 of the Federal Rules of Civil Procedure.[241] For the reasons given below, this

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238. *Cf.* American First Credit Union v. Shaw (*In re* Shaw), 114 B.R. 291, 297 (Bankr. D. Utah 1990) ("Filing a nondischargeability action sounding in fraud should never be a routine matter.... To use such a filing to 'shakedown' an honest debtor who is unable to fund a defense is reprehensible."); Jackson, *supra* note 35, at 1393 (discussing the importance of the bankruptcy discharge).

239. Unfortunately for both debtors and creditors, neither § 727(a)(4) nor the cases interpreting it have established the appropriate standard of proof for § 727(a)(4) cases. While it is clear from the cases that the creditor must carry the burden of proving that a knowing and fraudulent false oath has occurred, there currently is no consensus regarding whether the burden is the more lenient preponderance of evidence standard or the heightened clear-and-convincing evidence standard. *See, e.g.*, Rosen v. Bezner, 996 F.2d 1527, 1531 (3d Cir. 1993) (holding that creditor must prove that denial is warranted because discharge is at the heart of the "fresh start" and denial is extreme); Barbarosh, *supra* note 127, at 1214-15 (noting that no standard has yet been adopted by the Supreme Court and that lower court opinions reach differing results). This lack of clarity makes it somewhat more difficult for creditors to determine whether their grounds for objecting to a debtor's general discharge provide a reasonable basis for relief. Whatever standard the legislature feels is most appropriate should be added to § 727(a)(4). Most courts ultimately have held that the standard for denial of a discharge under § 727(a)(4) is the preponderance-of-evidence standard, *see* La Brioche, Inc. v. Ishkhanian (*In re* Ishkhanian), 210 B.R. 944, 949 (Bankr. E.D. Pa. 1997); Craig v. Kaler (*In re* Craig), 195 B.R. 443, 448-49 (Bankr. D.N.D. 1996); Dana Fed. Credit Union v. Holt (*In re* Holt), 190 B.R. 935, 939 (Bankr. N.D. Ala. 1996), rather than the heightened clear-and-convincing evidence standard, based on somewhat inapplicable language contained in the legislative history, *see* H.R. REP. NO. 95-595, at 153 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6340 ("The fourth ground for denial of discharge is the commission of a bankruptcy crime, though the standard of proof is [still] preponderance of the evidence, rather than proof beyond a reasonable doubt."). All this language really does, however, is clarify that the criminal standard is inapplicable. *Cf.* Grogan v. Garner, 498 U.S. 279, 286-91 (1991) (adopting less stringent standard in a § 523 case and stating in dicta that the standard for § 727(a)(4) complaints is set forth in its legislative history). Given the possibility of imprisonment and the harsh consequences of a successful complaint, the clear-and-convincing test seems more appropriate. *See, e.g.*, First Am. Bank v. Schraw (*In re* Schraw), 136 B.R. 301, 306 (Bankr. S.D. Fla. 1992); MacLeod v. Arcuri (*In re* Arcuri), 116 B.R. 873, 879 (Bankr. S.D.N.Y. 1990); Chittenden Trust Co. v. Mayo (*In re* Mayo), 94 B.R. 315, 325 (Bankr. D. Vt. 1988). Such an additional amendment would provide greater certainty to creditors when deciding whether to bring a complaint under § 727(a)(4).

240. FED R. BANKR. P. 9011.

241. *See id.* In fact, until recently, Rule 9011 was virtually identical to Federal Rule 11. Rule 11, which sanctions attorneys who bring federal complaints lacking any basis in

Bankruptcy Rule is no substitute for appropriate legislation that would curb existing abuses. While awaiting amendment to § 727(a)(4), Rule 9011 can and should be used to sanction creditor

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law or fact, provides in relevant part:

(a) SIGNATURE. Every pleading, written motion, and other paper shall be signed by at least one attorney of record in the attorney's individual name, or, if the party is not represented by an attorney, shall be signed by the party. Each paper shall state the signer's address and telephone number, if any. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) REPRESENTATIONS TO THE COURT. By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) SANCTIONS. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How Initiated.

(A) By Motion. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 5, but shall not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected. If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) On Court's Initiative. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subvision (b) with respect thereto.

FED. R. CIV. P. 11(a)-(c). The language in Rule 11(c)(1)(A), requiring that counsel notify the other side before requesting sanctions, was added to the rule in 1993. *See* McCoy v. West, 965 F. Supp. 34, 35 (D. Colo. 1997) (citing FED. R. CIV. P. 11).

behavior that undermines the purposes of the Bankruptcy Code, including frivolous or otherwise improper objections to discharge. Rule 9011 does not, however, satisfy the larger need for corrective legislation.

There are important procedural and substantive differences between Rule 9011 and statutorily imposed fees such as those imposed in § 523(d) and those proposed in this Article. Also, the effectiveness of Rule 9011 is undermined by judges who refuse to grant sanctions because doing so is considered too radical.[242] Judges must be willing to impose sanctions whenever they are warranted and to establish a reputation for punishing frivolous litigation. By doing so, the fresh start can receive the protection it deserves.

Bankruptcy Rule 9011[243] originally tracked Rule 11 of the Federal Rules of Civil Procedure and was adopted to remove any obstacles, real or perceived, to imposing sanctions in bankruptcy court.[244] Unlike Rule 11(c)(2)(A), Rule 9011 binds parties and

242. By analogy, two common criticisms of Rule 11 are that it multiplies the proceeding through side litigation over the alleged violation and that it improperly limits access to the courts. *See, e.g.*, Georgene M. Vairo, *Rule 11: Where We Are and Where We Are Going*, 60 FORDHAM L. REV. 475, 484-85 (1991) (noting Rule 11's tendency to limit advocacy in the federal courts in the areas of civil rights, employment discrimination, and other "disfavored" cases and its tendency to create satellite litigation); Paul Kaufman, Note, *A Prospective Cap on Rule 11 Sanctions*, 56 BROOK. L. REV. 1275, 1289 (1991) (arguing that current Rule 11 has a chilling effect on an attorney's willingness to challenge existing law and thus proposing limitations on the use of the rule); Note, *Plausible Pleadings: Developing Standards for Rule 11 Sanctions*, 100 HARV. L. REV. 630, 651 (1987) (arguing that courts resort to Rule 11 too frequently and broadly and thereby limit access to the courts by certain groups of largely underprivileged litigants). *But see* A. Simon Chrein, *The Actual Operation of Amended Rule 11*, 54 FORDHAM L. REV. 13, 15 (1985) (noting with disapproval the unwillingness of lawyers to move for sanctions against other lawyers, as well as the unwillingness of courts to impose sanctions, despite misrepresentations of the law, repeated harassing lawsuits, and other clearly sanctionable actions).

243. Bankruptcy Rule 9011 states in pertinent part:

> The signature of an attorney or a party constitutes a certificate that the attorney or party has read the document; that to the best of the attorney's or party's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation or administration of the case .... If a document is signed in violation of this rule, the court on motion or on its own initiative, shall impose on the person who signed it, the represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the document, including a reasonable attorney's fee.

FED. R. BANKR. P. 9011(a).

244. *See* Thomas M. Byrne, *Sanctions for Wrongful Bankruptcy Litigation*, 62 AM.

attorneys, both of whom are subject to its penalties if the rule is violated.[245] Rule 9011 is also broader than Rule 11, applying not only to all pleadings, written motions, and applications, but also to every document filed or served in a bankruptcy case,[246] except the bankruptcy schedules.[247]

Rule 9011's purpose is to discourage pleadings that are frivolous, legally untenable, or without factual basis, and to deter abuses of the judicial process.[248] Subjective good faith provides no protection under the rule, as the test is one of objective reasonableness.[249] Specifically, the rule is violated "where a party or attorney files or serves a document: (1) not well grounded in fact or not warranted by existing law or a good faith argument for extension, modification or reversal of existing law, when a reasonable inquiry would have revealed the deficiency, or (2) for an improper purpose."[250] The first prong

BANKR. L.J. 109, 112 (1988). The Court of Appeals for the Third Circuit has stated that the purpose of Rule 11, upon which Rule 9011 is based, is to "discourage pleadings that are 'frivolous, legally unreasonable, or without factual foundation, even [if] the paper was not filed in subjective bad faith.' " Lieb v. Topstone Indus., Inc., 788 F.2d 151, 157 (3d Cir. 1986) (quoting Zaldivar v. City of Los Angeles, 780 F.2d 823, 831 (9th Cir. 1986)). Although an element of compensation exists in the granting of sanctions, the primary purpose is to deter abuses of the legal system. *See* Doering v. Union County Bd. of Chosen Freeholders, 857 F.2d 191, 194 (3d Cir. 1988).

245. *See Doering*, 857 F.2d at 194. *Compare* FED. R. BANKR. P. 9011(a) ("The signature of an attorney or party constitutes a certification that the attorney or party has read the document .... If a document is signed in violation of this rule, the court ... shall impose on the person who signed it, the represented party, or both, an appropriate sanction ...."), *with* FED. R. CIV. P. 11(a) (stating that every pleading must be signed by at least one attorney and that the persons who sign the pleading may be sanctioned).

246. *See* FED. R. BANKR. P. 9011(a) (using the word "document," rather than "pleading, motions or other paper," when describing the papers upon which one may be sanctioned).

247. *See* Byrne, *supra* note 244, at 113.

248. *See* CUB Cadet Corp. Inc. v. Rosage (*In re* Rosage), 189 B.R. 73, 81 (Bankr. W.D. Pa. 1995).

249. *See id.* (citing Dura Sys., Inc. v. Rothburg Invs., Ltd., 886 F.2d 551, 556 (3d Cir. 1989)).

250. Byrne, *supra* note 244, at 114. An example of a statement that is not "warranted by existing law" and is lacking in a "good faith argument for the extension, modification or reversal of existing law" is "that the Debtor's disability income is not income and that assets in joint accounts with the Debtor's spouse are not assets of the estate" and, therefore, need not be disclosed on the bankruptcy schedules. Barnett Bank v. Muscatell (*In re* Muscatell), 116 B.R. 295, 297 (Bankr. M.D. Fla. 1990) (considering a case in which "the position taken by [debtor's attorney] was contrary to the most elementary, well-established bankruptcy principles, and no competent attorney could argue otherwise, in light of volumes of court decisions interpreting § 541 ... to the contrary" and noting that "even minimum research ... would have revealed that this position was completely without legal support"); *see also In re* Thomason, 161 B.R. 281, 284 (Bankr. N.D. Fla. 1993) (referring to statement in pleading "that a lender providing money for the purchase of goods cannot be the holder of a purchase money security interest unless the lender is

imposes a duty of reasonable inquiry and is by no means cured by an honest mistake.[251] Moreover, once the rule is violated, imposing sanctions is mandatory.[252]

Given that Rule 9011 is available in any bankruptcy proceeding, one might wonder why statutory sanctions such as § 523(d) are needed in connection with § 523(a), § 727(a), or any bankruptcy provision at all. There are, however, differences in the ways § 523(d) and Rule 9011 are applied. Section 523(d) arguably contains a more stringent standard than Rule 9011,[253] although according to many courts, the tests are identical.[254] Yet because of the "unjust" language of § 523(d), as compared to the mandatory nature of Rule 9011 sanctions, § 523(d) actually appears to be more discretionary.[255]

The primary difference between the statute and the rule is procedural. If a debtor proves that a creditor brought an unsuccessful nondischargeability complaint under § 523(a)(2), in

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also the seller of a good").

251. *See* Byrne, *supra* note 244, at 113 ("Bankruptcy Rule 9011 . . . sweeps away claims of 'honest mistake' as a complete defense to the imposition of sanctions."). Thus, under Rule 9011, unlike prior interpretations of Rule 11, a litigant can be sanctioned even if it did not have an improper purpose. A lawyer can believe that she is diligently pursuing a valid theory on behalf of a client, and if this belief is contrary to established law, the behavior is sanctionable. This is necessary to fulfill one of the primary purposes of the rule—namely, to compensate the party harmed by the frivolous action. *See* Doering v. Union County Bd. of Chosen Freeholders, 857 F.2d 191, 194 (3d Cir. 1988) (applying Rule 11).

252. *See* FED. R. BANKR. P. 9011 ("If a document is signed in violation of this rule, the court on motion or on its own initiative *shall* impose . . . an appropriate sanction . . . ." (emphasis added)); Styler v. Tall Oaks Inc. (*In re* Hatch), 93 B.R. 263, 267-68 (Bankr. D. Utah 1988) ("There is no discretion on the application of sanctions . . . . Under emerging case law, courts strictly adhere to the mandate of this rule.").

253. Under § 523(d), fees are imposed unless the creditor can prove that substantial justification exists for its position. *See* 11 U.S.C. § 523(d) (1994). In order for sanctions to attach, Rule 9011 requires virtually no basis in law or fact, so there can exist a small bit of justification that would preclude Rule 9011 sanctions, but not be substantial enough to ward off § 523(d). *See* Byrne, *supra* note 244, at 120-21 (arguing that § 523(d) imposes a stricter liability standard).

254. Because some § 523(d) cases use Rule 9011 to determine what is "substantially justified," the test may in fact be the same, rather than more stringent. *See, e.g.*, Middlefield Baking Co. v. Kassoff (*In re* Kassoff), 146 B.R. 194, 200-01 (Bankr. N.D. Ohio 1992) (failing to analyze the difference between the two standards and reaching the same result under each for similar reasons); *cf.* American First Credit Union v. Shaw (*In re* Shaw), 114 B.R. 291, 295 (Bankr. D. Utah 1990) (applying a Rule 11 standard to determine whether § 523(d) required the imposition of sanctions).

255. *See* Byrne, *supra* note 244, at 120-21. *Compare* 11 U.S.C. § 523(d) (requiring that fees be imposed if the creditor's acts were not "substantially justified" or if allowing fees would be "unjust"), *with* FED. R. BANKR. P. 9011 (stating that "[i]f a document is signed in violation of this rule, the court . . . *shall* impose . . . an appropriate sanction" (emphasis added)).

relation to a consumer debt, and the debt is discharged, the burden shifts to the creditor to prove either substantial justification or special circumstances that would make the fee award unjust.[256] There is no need for the debtor to bring another lawsuit, or to pay a lawyer to file more paperwork. Conversely, one must bring a separate motion to request the imposition of sanctions under Rule 9011.[257] For many debtors, this distinction is significant because they may not be able to bring a separate lawsuit due to cost constraints.

Applying Rule 11—or its bankruptcy counterpart, Rule 9011—poses other problems as well. Despite Rule 11's objective standard, some courts impose sanctions based on the "should have known" theory, or, in other words, based on the lawyer's experience or lack thereof.[258] Because the primary problem raised by the frivolous discharge objection is that it costs debtors money, this tendency is entirely inappropriate. That a lawyer thought the case was meritorious, due to ignorance, does not make it any less costly to defend. Rather, inexperience frequently adds to the costs by multiplying the proceedings.

Additionally, Rule 9011 is already in existence and does not seem to be much of a deterrent in cases involving objections or limitations to discharge.[259] While one author has noted that the

256. *See* 11 U.S.C. § 523(d); Chrysler First Credit Fin. Serv. Corp. v. Rhodes (*In re* Rhodes), 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988).

257. *Compare* FED. R. CIV. P. 11(c) (providing that the court may impose sanctions only "after notice and a reasonable opportunity to respond"), *with* FED. R. BANKR. P. 9011 (providing that the court may impose sanctions "on motion or on its own initiative").

258. Although inexperience will not technically excuse a lawyer from being sanctioned under amended Rule 11, as a practical matter, a court may excuse a lawyer who is young or inexperienced for ineptitude due to this lack of experience. *See, e.g.*, Darling v. MacPherson, Inc., Nos. 95-35734, 95-35868, 1996 WL 616648, at *3 (9th Cir. Oct. 23, 1996) (noting that lower court may have properly taken inexperience into account); Benton v. G & O Mfg., 921 F. Supp. 905, 909 (D. Conn. 1995) (limiting the amount of sanctions charged to an attorney because the attorney's behavior was due to inexperience rather than intent to harass).

259. Rule 9011 applies to all cases in bankruptcy, yet only two reported decisions have been found in which the rule has been applied against a creditor in the context of a frivolous objection to a general discharge under § 727(a)(4). *See* Summerlin v. Outlaw (*In re* Outlaw), 66 B.R. 413, 419 (Bankr. E.D.N.C. 1986) (considering case in which the creditor engaged in outrageous, not just unmeritorious, conduct, which included accusing the debtor of making undisclosed income as a call girl, an allegation the court found to be entirely unsupported); Chandry v. Usoskin (*In re* Usoskin), 56 B.R. 805, 813 (Bankr. E.D.N.Y. 1985) (considering case in which the creditors had no evidence of any wrongdoing, except that their debt remained unpaid, and thus seemed to misunderstand the very concept of discharge). There are, however, a number of cases discussing application of Rule 9011 in other forms of objections to discharge complaints. *See, e.g.*, Davis v. Hudgins, 896 F. Supp. 561, 573 (E.D. Va. 1995); Bielecki v. Nettleton, 183 B.R.

imposition of sanctions has been on the rise since Rule 9011 was promulgated, this increase is of no great surprise.[260] Under the Bankruptcy Act,[261] bankruptcy courts had very little authority to impose sanctions and hardly ever did so.[262] Bankruptcy courts still are reluctant to impose sanctions under Rule 9011 unless the behavior in question is truly outrageous and not just ignorant.[263] Moreover, many courts seem to associate Rule 9011 sanctions only with improper bankruptcy filings, imposing them only against debtors and their attorneys.[264] Some judges may be reluctant to impose sanctions at all.[265]

Sanctions under § 523(d), however, are another story. They are imposed fairly routinely, pursuant to the section's specific language,[266] and appellate courts regularly overrule Bankruptcy Court decisions in which no justification is provided for a failure to impose § 523(d)

143, 149 (N.D. Ill. 1995); Gibson v. City of Alexandria, 885 F. Supp. 133, 157 (E.D. Va. 1994); Upadhyay v. Burse, 120 B.R. 833, 837-38 (Bankr. E.D. Va. 1990); Norwood Fed. Sav. & Loan Ass'n v. Guiltinan, 58 B.R. 542, 544-45 (Bankr. S.D. Cal. 1986); Chaudhry v. Ksenzowski (*In re* Ksenzowski), 56 B.R. 819, 834 (Bankr. E.D.N.Y. 1985).

260. Until 1983, there was no set procedure under which a bankruptcy court could impose sanctions. *See* Byrne, *supra* note 244, at 109-10.

261. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (current version at 11 U.S.C. §§ 101-1330 (1994)).

262. *See id.*

263. *See* Chrein, *supra* note 242, at 15.

264. *See, e.g., In re* Thomason, 161 B.R. 281, 284-85 (Bankr. N.D. Fla. 1993) (imposing sanction against Chapter 7 debtor's counsel); Whitney Apartments Assocs. v. McGlamry (*In re* Whitney Place Partners), 123 B.R. 117, 124-25 (Bankr. N.D. Ga. 1991) (imposing sanctions against a Chapter 11 debtor partnership); Bank of Mississippi v. McIntyre (*In re* McIntyre) 96 B.R. 70, 71 (Bankr. S.D. Miss. 1989) (imposing sanctions against a Chapter 7 debtor); *In re* Reid, 92 B.R. 21, 25-26 (Bankr. D. Conn. 1988) (imposing fees against a Chapter 12 debtor's counsel). Scholarship on Rule 9011, of which there is very little, also focuses on improper behavior on the part of the debtor. *See, e.g.*, Byrne, *supra* note 244, at 116-28 (listing numerous ways in which debtors' attorneys have been sanctioned under Rule 9011 and very few in which creditors' attorneys have been sanctioned); Note, *The Ethical Role of a Debtor's Attorney in a Consumer Bankruptcy Filing*, GEO. J. LEGAL ETHICS 665, 678-79 (1993) (discussing how to use Rule 9011 against debtor's counsel).

265. *See* Byrne, *supra* note 244, at 129 ("[T]he reported decisions do not suggest that Rule 9011 is being overzealously invoked by bankruptcy courts."); Chrein, *supra* note 242, at 15 (noting courts' unwillingness to impose sanctions, even in the face of unethical behavior). Moreover, while Byrne states that the threat of sanctions is now inescapable under Rule 9011, *see* Byrne, *supra* note 244, at 128, either many inappropriate creditor actions escape scrutiny under this rule or large numbers of meritorious suits are filed but for some unexplainable reason are unsuccessful.

266. *See, e.g.*, Firstbanks v. Goss (*In re* Goss), 149 B.R. 460, 464 (Bankr. E.D. Mich. 1992); ITT Consumer Fin. Corp. v. Mull (*In re* Mull), 122 B.R. 763, 766-67 (Bankr. W.D. Okla. 1992); Morrissey v. Wiencek (*In re* Wiencek), 58 B.R. 485, 491 (Bankr. E.D. Va. 1986).

sanctions.[267] Thus, this type of statutory sanction has been at least somewhat successful in deterring frivolous creditor litigation.

For this reason, some amendment to § 727 is needed in order to keep creditors in line. Shifting the cost of litigation to creditors who bring an unsuccessful objection to discharge is necessary in order to protect individual debtors against improper leverage litigation. The stakes are simply too high, from a litigation cost perspective alone, and there currently is no incentive for creditors not to bring meritless objections to discharge.[268]

VIII. CONCLUSION

The problem created by the current statutory scheme is that creditors can bring meritless suits in order to pressure debtors to pay pre-petition claims. As the policies behind § 523(d) establish,[269] as long as a creditor can withdraw a meritless complaint after being threatened with sanctions, there is no incentive whatsoever not to bring one, regardless of its merits. As long as a significant portion of these complaints generate settlements favorable to creditors and they are not further deterred, they will continue to be brought. A disproportionate number of settlements will result because debtors cannot afford counsel to defend these expensive actions. The threat of imprisonment for making an honest mistake—though in reality

267. *See In re* Hingson, 954 F.2d 428, 429-30 (7th Cir. 1992) (holding that the bankruptcy court's decision not to award attorney fees could not be based solely on the fact that a claim of fraud stemmed from a family feud).

268. Suits brought for the purpose of harassment—or, put another way, for the purpose of extracting a settlement on a pre-petition debt—are one evil against which to protect; suits brought in ignorance pose another threat. Deadlines come and ill-prepared attorneys file suits. Once such a case is filed, the debtor should be compensated for defending it. The motivation for its institution is irrelevant because the goal of such a statute is compensatory. Thus, as many courts have recognized in the context of existing § 523(d), withdrawing the complaint should not relieve the creditor from paying the debtor's fees. *See, e.g.*, In re *Goss*, 149 B.R. at 463; In re *Mull*, 122 B.R. at 766; United States Dep't of Hous. & Urban Dev. v. Armstead (*In re* Armstead), 106 B.R. 405, 415 (Bankr. E.D. Pa. 1989). Because the mere filing of a complaint objecting to the dischargeability of a debt can encourage a debtor to settle a suit, a creditor should not be able to avoid sanctions under § 523(d) merely by withdrawing the suit. Withdrawal should merely mitigate the fees and expenses the creditor must pay on behalf of the debtor.

Recently amended Rule 11, however, now provides that a party can avoid sanctions by dismissing the action in question and that notice of an intention to request fees under Rule 11 must be provided. *See* FED. R. CIV. P. 11. This amendment provides an opportunity to withdraw the action before the request for sanctions is made to the court. *See id.* If this amendment is similarly adopted in Rule 9011, the section will be of very little practical assistance in the context of meritless § 727(a)(4) complaints.

269. *See supra* notes 167-79 and accompanying text.

slim—will seem great when the creditor makes such a threat, and the debtor's typically undercompensated attorney can neither ensure a successful defense nor work for free. Thus, § 727 should be amended to cure this deficiency.

Rule 9011 alone does not address these problems, and its major drawbacks in this context already have been noted. A debtor ordinarily must request affirmative relief against the creditor in bankruptcy court in order to recover under Rule 9011.[270] And, under current circumstances, the rule is not used to impose sanctions sufficient to deter the most harmful forms of creditor abuse.

Pending an amendment, however, Rule 9011 should be used to sanction frivolous creditor action, despite its weaknesses. Debtors' counsel should be aware of Rule 9011 and should make opposing counsel aware as well that it applies in all actions in a bankruptcy case, including those taken by creditors.[271]

Perhaps the most meaningful action that can be taken, pending an appropriate amendment, is judicial. Judges can keep their eyes on particular creditors and watch for institutional abuses. They also can schedule quick judicial determinations of objections to discharge in order to avoid delaying the most fundamental protection provided to individual bankruptcy debtors under the Bankruptcy Code. Finally, and most importantly, judges can impose sanctions under Rule 9011, sua sponte, in recognition of the realistic economic situation of many individual debtors. The bankruptcy rules permit the sua sponte imposition of sanctions, and a sua sponte ruling is more effective and less costly than suggesting that debtor's counsel file a sanctions motion. Thus, while not a perfect solution, Rule 9011 can be used more effectively by both courts and debtors' counsel in deterring creditor abuses, pending amendment of § 727.

270. *See supra* notes 256-57 and accompanying text.

271. *See supra* notes 248-52 and accompanying text.