



Private Parties and Bankruptcy-Based Discrimination

DOUGLASS G. BSHKOFF*

INTRODUCTION

Some effects of bankruptcy are readily apparent. Collection activity must immediately cease,¹ never to resume if all of the debtor's obligations are discharged.² Ailing businesses must be given an opportunity to regain their health. Bankruptcy, nonetheless, can never be the act of a magician, instantly transforming the beleaguered debtor into a carefree entity with a successful past and a promising future. It affords only the opportunity for rehabilitation.³ There is no guarantee of success. The debtor's future will be determined by its post-petition achievements. Society's response to these efforts, and ultimately their success, will, in turn, be influenced by prevailing attitudes toward bankruptcy. Those who deal with the debtor cannot be expected to ignore the fact of bankruptcy. Yet a return to productive society cannot be achieved unless the debtor is given a fair chance to succeed. Effective re-

* Professor of Law, Indiana University School of Law, Bloomington. I am grateful for the comments of Daniel Conkle, Theodore Eisenberg, John McCoid and William Popkin. Gregory Wooldrige, Class of 1988, provided helpful research assistance.

1. 11 U.S.C. § 362 (1982).

2. 11 U.S.C. § 524(a)(2) (1982).

3. Rehabilitation may mean simply giving the debtor a discharge and the chance to start over. It also may mean giving the debtor the opportunity to propose and perform a plan under either Chapter 11 or 13 of the Bankruptcy Code. Courts have recognized that effective rehabilitation in the latter context requires the extension of protection to one who has not yet received a discharge. *See, e.g., In re Young*, 10 Bankr. 17 (Bankr. S.D. Cal. 1980) (improper to refuse renewal of license during Chapter 13 proceeding); *In re Heath*, 3 Bankr. 351 (Bankr. N.D. Ill. 1980) (withholding of grade transcript); *In re Parkman*, 27 Bankr. 460 (Bankr. N.D. Ill. 1983) (refusal to allow debtor to attend university classes). But many of the cases which refuse to condemn private party discrimination concern a bankruptcy under Chapter 11 or 13 and make it more difficult to achieve the rehabilitation contemplated by those proceedings.

habilitation, therefore, requires more than simply calling a halt to direct collection activity.

The United States Supreme Court was well aware of this when, in *Perez v. Campbell*,⁴ it struck down a state statute which denied a driver's license to a debtor who had failed to pay a debt arising out of an automobile accident even though it had been discharged. The lack of a license interfered with the opportunity for rehabilitation. Part of the *Perez* doctrine is carried forward in section 525 of the Bankruptcy Code, which prohibits bankruptcy-based discrimination by governmental units and, since 1984, also forbids employment discrimination by private parties.⁵ This provision presents a significant interpretative problem. Not all possible acts or actors fall within its terms. To what extent is the Bankruptcy Court free to enjoin activity not mentioned in the statute?⁶ Some debtors have argued that the prohibitions of section 525, nonetheless, extend to forms of discrimination, specifically private party discrimination, not condemned by Congress. The weight of authority is opposed to this view. The Seventh Circuit in *Wilson v. Harris*

4. 402 U.S. 637 (1971).

5. 11 U.S.C. § 525 (Supp. III 1985) is titled "Protection against discriminatory treatment" and reads as follows:

(a) Except as provided in the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. §§ 499a-499s), the Packers and Stockyards Act, 1921 (7 U.S.C. §§ 181-229), and section I of the Act entitled "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes," approved July 12, 1943 (57 Stat. 422; 7 U.S.C. § 204), a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

(b) No private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title, a debtor or bankrupt under the Bankruptcy Act, or an individual associated with such debtor or bankrupt, solely because such debtor or bankrupt—

(1) is or has been a debtor under this title or a debtor or bankrupt under the Bankruptcy Act;

(2) has been insolvent before the commencement of a case under this title or during the case but before the grant or denial or a discharge; or

(3) has not paid a debt that is dischargeable in a case under this title or that was discharged under the Bankruptcy Act.

Part (a) contains the original statutory text. Part (b) was added in 1984.

6. One commentator has written that "[p]erhaps the most difficult problem in the interpretation of statutes is that of determining whether a negative implication exists and, if so, how far it extends." F. DICKERSON, *THE INTERPRETATION AND APPLICATION OF STATUTES* 235 n.58 (1975). After adoption of § 525 of the Bankruptcy Code, the problem was whether the prohibition of governmental discriminatory activity carried with it the negative implication that private discriminatory activity was permissible. Following the 1984 amendment, the question

Trust and Savings Bank,⁷ for example, recently rejected a claim that section 525, prior to the 1984 amendment, either expressly or by analogy prohibited a private employer from firing a debtor who had commenced a voluntary proceeding. This Article suggests that, notwithstanding *Wilson* and similar authority, there is still good reason to conclude that discrimination of almost all types is prohibited, not necessarily by anything found in section 525 but by more fundamental conceptions of bankruptcy policy.⁸ Since Congress has specifically condemned some bankruptcy-based discrimination, it will be helpful to begin by reviewing the legislative process which produced section 525.

I. THE ORIGIN OF SECTION 525

Most bankruptcy legislation is shaped by policies of Congressional origin. Some parts of the statute, of course, respond to judicial decisions, correcting defects revealed in many years of interpretation.⁹ Bankruptcy, nevertheless,

was narrowed to whether there was a negative implication that private party discrimination other than that related to employment was still consistent with bankruptcy policy:

Several Latin maxims masquerade as rules of interpretation while doing nothing more than describing results reached by other means. The best example is probably *expressio unius est exclusio alterius*, which is a rather elaborate, mysterious sounding, and anachronistic way of describing the negative implication. Far from being a rule, it is not even lexicographically accurate, because it is simply not true, generally, that the mere express conferral of a right or privilege in one kind of situation implies the denial of the equivalent right or privilege in other kinds. Sometimes it does and sometimes it does not, and whether it does or does not depends on the particular circumstances of context. Without contextual support, therefore, there is not even a mild presumption here. Accordingly, this maxim is at best a description, after the fact, of what the court has discovered from context.

Id. at 234-35 (footnotes omitted).

7. 777 F.2d 1246 (7th Cir. 1985). See also *Ryan v. Ohio Edison Co.*, 611 F.2d 1170 (6th Cir. 1979) (no implied cause of action against private party); *Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977) (withholding of college transcript); *In re Brown*, 49 Bankr. 558 (Bankr. M.D. Pa. 1985) (withholding of services by credit union); *Hennen v. Dayton Power & Light Co.*, 17 Bankr. 720 (Bankr. S.D. Ohio 1982) (dictum); *In re Coachlight Dinner Theatre of Nanuet, Inc.*, 8 Bankr. 657 (Bankr. S.D.N.Y. 1981) (refusal to accept advertising); *In re Barbee*, 14 Bankr. 733 (Bankr. E.D. Va. 1981) (employment termination); *In re Northern Energy Products*, 7 Bankr. 473 (Bankr. D. Minn. 1980) (credit report); *Handsome v. Rutgers University*, 445 F. Supp. 1362 (D.N.J. 1978) (withholding of college transcript—dictum). A few cases indicate that private discriminatory activity is illegal, often without reliance upon § 525 of the Bankruptcy Code: *In re Olson*, 38 Bankr. 515 (Bankr. N.D. Iowa 1984) (dictum); *In re Amber Lingerie, Inc.*, 30 Bankr. 736 (Bankr. S.D.N.Y. 1983) (relying upon § 105 rather than § 525); *In re Blackwelder Furniture Co.*, 6 Bankr. Ct. Dec. (CRR) 1337 (Bankr. W.D.N.C. Oct. 7, 1980) (relying upon § 105); *In re Cahokia Downs, Inc.*, 5 Bankr. 529 (Bankr. S.D. Ill. 1980) (relying upon §§ 105, 363 and 365); *Heath*, 3 Bankr. 351 (dictum).

8. This Article assumes that the bankruptcy clause authorizes Congress to prohibit all forms of discrimination by both public and private entities: "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law . . ." *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 192 (1902).

9. 11 U.S.C. § 547(e)(3) (1982), for example, repudiates the reasoning, but not the result, in *Grain Merchants of Ind., Inc. v. Union Bank and Sav. Co.*, 408 F.2d 209 (7th Cir.), *cert.*

is essentially a legislative, not a judicial creation. Section 525 of the Bankruptcy Code, as originally enacted, is unusual because it is the product of Congress' decision to codify a judicially developed doctrine of debtor protection.¹⁰ The decision in *Perez v. Campbell*¹¹ thus provides an interpretative context for section 525.

The facts of *Perez* were fairly simple. Arizona law permitted the Commissioner of Motor Vehicles to withhold driving and car registration privileges from any person who had been involved in a motor vehicle accident and had failed to satisfy a judgment arising out of that incident. The clash between state law and bankruptcy policy was evident. Since state law did not recognize the bankruptcy discharge as a form of satisfaction, the licensing statute created pressure on the debtor to pay the claim, notwithstanding the protective effect of the discharge. Such pressure was inconsistent with the rehabilitative function of bankruptcy proceedings. The Court held that the Arizona statute had to yield to the imperatives of federal bankruptcy policy.

In one sense, this decision was rather remarkable. The Court had twice previously confronted the same issue and, on each occasion, taking a very unrealistic view of the effect of the licensing law, had deferred to the wishes of the state legislature.¹² The complete repudiation of these precedents represented a remarkable change in attitude concerning the appropriate relationship between state and federal law and evidenced a strong commitment to the implementation of bankruptcy policy. Justice White wrote:

We can no longer adhere to the aberrational doctrine of *Kesler* and *Reitz* that state law may frustrate the operation of federal law as long as the state legislature in passing its law had some purpose in mind other than one of frustration. Apart from the fact that it is at odds with the approach taken in nearly all our Supremacy Clause cases, such a doctrine would enable state legislatures to nullify nearly all unwanted federal legislation by simply publishing a legislative committee report articulating some state interest or policy—other than frustration of the federal objective—that would be tangentially furthered by the proposed state law. In view of the consequences, we certainly would not apply the *Kesler* doctrine in all Supremacy Clause cases. Although it is possible to argue that *Kesler* and *Reitz* are somehow confined to cases involving either bankruptcy or highway safety, analysis discloses no reason why the States should have broader power to nullify federal law in these fields than in

denied, 396 U.S. 827 (1969). See S. REP. No. 989, 95th Cong., 2d Sess. 89 (1978); H.R. REP. No. 595, 95th Cong., 1st Sess. 374 (1977); 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5875, 6330.

10. 11 U.S.C. § 525, however, is not unique. *Dean v. Davis*, 242 U.S. 438 (1917) was codified in a somewhat altered form in 11 U.S.C. § 67(d)(3) (1976) of the now repealed Bankruptcy Act of 1898. See REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137, 93rd Cong., 1st Sess., pt. II, at 177 (1973) [hereinafter REPORT]. It appears that § 525(b) was enacted to *overrule In re Barbee*, 14 Bankr. 733 (Bankr. E.D. Va. 1981).

11. 402 U.S. 637 (1971).

12. *Kesler v. Department of Public Safety*, 369 U.S. 153 (1962); *Reitz v. Mealey*, 314 U.S. 33 (1941).

others. Thus, we conclude that *Kesler* and *Reitz* can have no authoritative effect to the extent they are inconsistent with the controlling principle that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause. Section 28-1163 (B) thus may not stand.¹³

In another sense, however, *Perez* was a predictable and not particularly radical decision. It represented only a modest extension of the decision in *Local Loan Co. v. Hunt*,¹⁴ the most important previous attempt of the Court to establish the contours of debtor rehabilitation policy. The issue in *Hunt* was whether the lien created by a wage assignment attached to those wages earned after the debtor had filed a voluntary petition. The Illinois law on this matter was clear. The lien continued to be effective following bankruptcy. The position of the United States Supreme Court was expressed with equal certainty by Mr. Justice Sutherland:

When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be small, but the principle, once established, will equally apply where both are very great. The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.¹⁵

Perez is not an extraordinary extension of the protection announced in *Hunt* when the strength and conviction of Justice Sutherland's statement is considered. Its major contribution to the jurisprudence of debtor rehabilitation is the recognition that activity by someone other than a creditor, in this instance the Arizona Commissioner of Motor Vehicles, can impermissibly interfere with the "new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor." Such interference is improper even when the third party actor does not reap any financial benefit from obstruction of the rehabilitation effort. It is the lessening of the beneficial effect of bankruptcy, not any gain realized by the actor, that is crucial.¹⁶

13. *Perez*, 402 U.S. at 651-52.

14. 292 U.S. 234 (1934).

15. *Id.* at 245.

16. *Perez* requires that the validity of the state law be determined by an analysis of its effect upon debtors as a class. Justice White makes this clear in his rejection of legislative motive as a justification for the state rule. See *supra* text accompanying note 13.

Shortly after the decision in *Perez*, the Bankruptcy Commission published its proposals for restructuring our bankruptcy law. Prominent among these proposals was section 4-508 of the Bankruptcy Code, entitled "Protection Against Discriminatory Treatment" which, according to the Commission's note, "codifie[d] the principle in *Perez v. Campbell* . . ."¹⁷ The sweep of the decision was amply reflected¹⁸ in the language offered for Congressional approval:

A person shall not be subjected to discriminatory treatment because he, or any person with whom he is or has been associated, is or has been a debtor or has failed to pay a debt discharged in a case under the Act. This action does not preclude consideration, where relevant, of factors other than those specified in the preceding sentence, such as present and prospective financial condition or managerial ability.¹⁹

Congress did not adopt the Commission's recommendation but chose the less ambitious policy statement embodied in the original version of section 525.²⁰ It abandons the comprehensive prohibition of section 4-508 and condemns only governmental actions. Language in both the House and Senate Reports suggests, nonetheless, that section 525 does not mark the outer limits of debtor protection. We are told that:

In addition, the section is not exhaustive. The enumeration of various forms of discrimination against former bankrupts is not intended to permit other forms of discrimination. The courts have been developing the *Perez* rule. This section permits further development to prohibit actions by governmental or quasi-governmental organizations that perform licensing functions, such as a State bar association or a medical society, or by other organizations that can seriously affect the debtors' livelihood or fresh start, such as exclusion from a union on the basis of discharge of a debt to the union's credit union.

The effect of the section, and of further interpretations of the *Perez* rule, is to strengthen the anti-reaffirmation policy found in section 524(b). Discrimination based solely on nonpayment could encourage reaffirmations, contrary to the expressed policy.

Perez, however, does not require invalidation of a rule which has a nondiscriminatory adverse effect on debtor and nondebtor alike, even if it interferes with rehabilitation. A state, for example, may require all drivers to establish financial responsibility. It cannot impose a financial responsibility requirement only on those drivers who have been involved in bankruptcy proceedings.

17. REPORT, *supra* note 10, pt. I, at 144.

18. It is not clear why such broad language appeared in the original proposal. The Commission's note to this section discusses only discrimination by governmental units. Perhaps the broad sweep of § 525 was drafting inadvertence. Professors Kennedy and Viles both support this view. See *Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary, 94th Cong., 1st Sess.*, pt. I, at 36 [hereinafter *Bankruptcy Reform Hearings*] (statement of Frank Kennedy); Viles, *Non-Revolutionary Bankruptcy Act Proposed by the National Bankruptcy Commission*, 29 BUS. LAW 1117, 1127 (1974).

19. REPORT, *supra* note 10, pt. I, at 143-44.

20. Section 525 was amended in 1984 to prohibit private party employment discrimination. See *supra* note 5.

The section is not so broad as a comparable section proposed by the Bankruptcy Commission, S. 236, 94th Cong., 1st Sess. § 4-508 (1975), which would have extended the prohibition to any discrimination, even by private parties. Nevertheless, it is not limiting either, as noted. The courts will continue to mark the contours of the antidiscrimination provision in pursuit of sound bankruptcy policy.²¹

This language is maddeningly ambiguous²² and, notwithstanding the disclaimer, one might conclude that Congress' rejection of the Bankruptcy Commission's proposal evidenced a desire to limit the long-term impact of the *Perez* decision. It would follow, then, that courts should not move far, if at all, beyond the words of this section when confronted by clearly discriminatory activity. An examination of the legislative record, however, shows that such a conclusion would be completely unwarranted. The shift to the narrow language of section 525 was caused by complaints that the Commission proposal would force lenders to deal with poor credit risks. Almost without exception, the opposition to section 4-508 came from the consumer credit industry which feared that enactment of this statute would adversely affect credit granting practices. There is ample evidence of this in testimony that was offered in both the House and the Senate.²³

21. H.R. REP. NO. 595, *supra* note 9, at 366-67; S. REP. NO. 989, *supra* note 9, at 81.

22. The first paragraph, which refers to "governmental or quasi-governmental organizations . . . or . . . other organizations such as . . . a union," supports the view that discrimination even by private parties can be condemned. But the last paragraph, noting that private party discrimination is clearly not prohibited, points in the other direction.

23. The testimony of Alvin Q. Wiese before the Senate committee is typical of the objections which were voiced:

On discrimination, both bills provide that "a person shall not be subjected to discriminatory treatment." The National Consumer Finance Association believes that prohibitions against discriminatory treatment, being in the nature of civil rights legislation, has no place in the Bankruptcy Act itself.

We fear that the language in the section, as drafted, could be susceptible to misinterpretation in its application in the field of credit granting. The Commission's report makes it clear that in its opinion discriminatory treatment improperly frustrates a major policy of the Bankruptcy Act and constitutes an erosion of the fresh start approach. In explaining the purpose of this section, the Commission report states:

Therefore, the Commission recommends that no one be subjected to discriminatory treatment because he, or any person with whom he is or has been associated, is or has been a debtor or has failed to pay a discharged debt in a case under the Act.

The fact of a bankruptcy is a fact, and it cannot be erased. The consequences of that fact within the credit industry are bound to be interpreted, correctly or incorrectly, as discrimination, and lead to confusion, uncertainty, and litigation.

Legislative prohibition against discrimination should not form a part of the Bankruptcy Act. It should be left to the Equal Credit Opportunity Act or other measures and bills for regulation.

Bankruptcy Reform Hearings, *supra* note 18, pt. 1, at 173 (1975). See also *id.* at 129-30 (statement of Walter W. Vaughn); *id.* pt. 2 at 433 (statement of National Association of Credit Management) and 486 (statement of Rex Lee, Ass't Attorney General: "Section 4-508 should be deleted lest it give rise to a flood of discrimination suits brought to harass those who lend,

The legislative history of section 525 of the Bankruptcy Code does not clearly indicate why section 4-508 was originally placed before Congress. Given the Commission's commitment to improve the "system of financial rehabilitation of financially troubled individuals,"²⁴ it is not reasonable to infer any desire to limit development of the *Perez* doctrine. It is similarly clear that the Congressional retreat from the Commission proposal was a response to the complaints of the consumer credit industry and stands as no evidence of a desire to place limits on the *Perez* rule, either in terms of acts prohibited (other than discrimination in credit transactions)²⁵ or actors subject to sanctions for discrimination. Section 525 should, therefore, be seen as only one, not the sole, source of protection against bankruptcy-based discrimination. Courts have not, however, always interpreted it in this manner.

II. JUDICIAL REACTION TO SECTION 525

The post-*Perez* decisions fall into two groups: (1) those in which governmental agencies are taken to task for acts including, and in addition to, driver's license revocations; and (2) those involving non-governmental agencies. Governmental litigation has produced few surprises. It is possible to disagree with the language or results in particular instances,²⁶ but generally,

sell and contract.") *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess., pt. 3, at 2120 (1976) (statement of Richard Lavine); Twinem, *Bankruptcy Report: Some Limitations on Creditors' Rights*, 29 BUS. LAW 353, 366 (1974).

24. REPORT, *supra* note 10, pt. I, at 169.

25. An explicit protective provision prevents the trustee from assuming a contract to extend credit. 11 U.S.C. § 365(c)(2) (1982).

26. The court in *In re Marine Elec. Ry. Prods. Div., Inc.*, 17 Bankr. 845 (Bankr. E.D.N.Y. 1982) found a violation of § 525 despite the government's argument that its refusal to deal with a Chapter 11 debtor was justified by the likelihood of conversion to Chapter 7 and the difficulty of then finding someone to replace the debtor. It then went on to dismiss the debtor's complaint on other grounds. The government's argument that there were legitimate reasons for the discrimination deserved more attention than it received. See *infra* text accompanying note 79 (example 4).

Given the special concern regarding credit transactions as demonstrated in the legislative history of § 525, *In re Richardson*, 15 Bankr. 925 (Bankr. E.D. Pa. 1981) was clearly wrong in holding that the Pennsylvania Higher Assistant Agency violated § 525 by making failure to repay loans a ground for denying further credit. This anomaly was corrected when the court vacated its previous decision one year later in *In re Richardson*, 27 Bankr. 560 (Bankr. E.D. Pa. 1982). Two other decisions, however, *In re Rose*, 9 Bankr. Ct. Dec. (CRR) 885 (Bankr. D. Conn. Oct. 7, 1982) and *In re Helms*, 46 Bankr. 150 (Bankr. E.D. Mo. 1985), overlook the legislative history but still reach results favorable to the government. *In re Goldrich*, 771 F.2d 28 (2d Cir. 1985) states the correct position on discrimination in credit transactions. A prior bankruptcy is a legitimate basis for denying credit in all cases, even those in which there is no other justification.

Posing similar difficulties is *Duffey v. Dollison*, 734 F.2d 265 (6th Cir. 1984), which upholds an Ohio statute which requires proof of financial responsibility following failure to satisfy a

courts have been able to achieve appropriate results when assessing the conduct of public agencies.²⁷ One cannot have the same sanguine view of non-governmental litigation. Debtors usually have failed to convince the courts that private party discrimination is inconsistent with bankruptcy policy.²⁸ Indeed, judicial sensitivity was so seriously lacking in employment termination cases that Congress added a prohibition against bankruptcy-based firings by private employers in the summer of 1984²⁹—a season not to be remembered for demonstration of any excessive sympathy toward debtor interests.³⁰

One finds a disturbing phenomenon in some litigation involving private entities, the use of section 525 as a bar to recovery.³¹ The most egregious example of unwillingness to move beyond the precise words of that section is found in *Wilson v. Harris Trust & Savings Bank*.³² There an employee brought an action against her former employer alleging wrongful discharge and a violation of section 525. This litigation was commenced before the 1984 amendment and the plaintiff was forced to concede that she did not

judgment within 30 days even if the debt is subsequently discharged in bankruptcy. See Boshkoff, *Financial Responsibility Laws and Bankruptcy: A Comment on Duffey v. Dollison*, NORTON BANKR. LAW ADV., No. 11, Nov. 1984, at 4.

27. See *Island Club Marina, Ltd. v. Lee County*, 38 Bankr. 847 (Bankr. D. Ill. 1984) (refusal to honor validly issued building permit); *In re Rath Packing Co.*, 35 Bankr. 615 (Bankr. N.D. Iowa 1983) (revocation of self-insurance exemption); *In re Son-Shine Grading, Inc.*, 27 Bankr. 693 (Bankr. E.D.N.C. 1983) (debtor disqualified from bidding on public contract); *In re Latchaw*, 24 Bankr. 457 (Bankr. N.D. Ohio 1982) (disciplinary action by employer); *In re Anderson*, 15 Bankr. 399 (Bankr. S.D. Miss. 1981) (failure to renew liquor license); *In re Maley*, 9 Bankr. 832 (Bankr. W.D.N.Y. 1981) (denial of liquor license); *In re Gibbs*, 9 Bankr. 758 (Bankr. D. Conn. 1981) (eviction of tenant from public housing project); *In re Young*, 10 Bankr. 17 (Bankr. S.D. Cal. 1980) (refusal to renew driver's license during pendency of Chapter 13 proceeding); *In re Heath*, 3 Bankr. 351 (Bankr. N.D. Ill. 1980) (withholding of grade transcript); *In re Howren*, 10 Bankr. 303 (Bankr. D. Kan. 1980) (withholding of grade transcript); *Handsome v. Rutgers University*, 445 F. Supp. 1362 (D.N.J. 1978) (withholding of grade transcript). There are also numerous driver's license cases collected in Annotation, *Protection of Debtor from Acts of Discrimination by Governmental Units Under § 525 of Bankruptcy Code of 1978* (11 U.S.C.S. § 525), 68 A.L.R. FED. 137 (1984).

28. See authorities cited *supra* note 7.

29. See 11 U.S.C. § 525(b), *supra* note 5. The new provision is discussed in Chobot, *Anti-Discrimination Under the Bankruptcy Laws*, 60 AM. BANKR. L.J. 185, 196-201 (1986). There is no mention of 11 U.S.C. § 525(b) (Supp. III 1985) in the House or Senate debates or committee reports.

30. Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM. & MARY L. REV. 91, 163-64 (1985).

31. A similar problem exists with regard to U.C.C. § 2-318 (1958). There are three alternative versions of this provision which defines the parties (other than the buyer) who are entitled to the benefit of express and implied warranties. Official Comment 3 attempts to foreclose the argument that the first alternative fixes the outer limits of warranty protection: "the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other parties in the distributive chain." This provision has inspired a substantial amount of litigation and scholarly comment. See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 11-3 (2d ed. 1980); F. DICKERSON, *supra* note 6, at 235 n.58.

32. 777 F.2d 1246 (6th Cir. 1985).

come within the express language of the statute. Cases applying section 525 to private entities were dismissed with the citation of cases going in the other direction including *McLellan v. Mississippi Power & Light Co.*,³³ a pre-Code case. As for section 525, this anti-discrimination statute was advanced as a justification for discrimination. Addressing this topic, the Seventh Circuit explained that:

We agree with the majority's interpretation of the statute. Congress carefully considered extending the anti-discrimination section to private entities and purposefully rejected it as being overbroad. Where the terms of the statute are unambiguous, reliance on legislative history is inappropriate, absent rare and exceptional circumstances. *Pullman-Standard v. I.C.C.*, 705 F.2d 875, 879 (7th Cir. 1983). Section 525 is specifically worded to apply to governmental units. The Bank is clearly not a governmental unit. We cannot find a cause of action under § 525 when Congress has expressly declined to provide one.

Moreover, Congress amended § 525 in 1984 to provide that the prohibitions in § 525(a) now apply to private, as well as public employers. See 11 U.S.C. § 525(b). Congress would not have added this provision if it thought private employers were already barred from discriminating against debtors under § 525.³⁴

This statutory reasoning is quite unsatisfactory. It is not true that adoption of one statutory rule retroactively establishes the existence of a contrary rule. Two early twentieth century bankruptcy decisions are instructive in this regard. *Dunbar v. Dunbar*³⁵ presented the question of whether a liability arising under a support agreement was dischargeable in bankruptcy. The applicable statutory law did not directly address this issue. A subsequent amendment specifically provided for nondischargeability. The United States Supreme Court held that the obligations were nondischargeable under the pre-amendment language and then referred to the post-amendment version of the statute for support stating that:

The amendments to the bankruptcy act passed in 1903, 32 Stat. 797, contain an amendment of section 17 of the act of 1898, which relates to debts not affected by a discharge, and it provides, among those not released by a discharge in bankruptcy, a debt due or to become due for alimony, or for the maintenance or support of wife or child. It is true that the provisions of the amendatory act are not to apply to cases pending before their enactment. They are only referred to here for the purpose of showing the legislative trend in the direction of not discharging an obligation of the bankrupt for the support and maintenance of wife or children.³⁶

Approximately two years later, in *Wetmore v. Markoe*,³⁷ the Court had the opportunity to comment again on the effect of this amendment:

33. 545 F.2d 919 (5th Cir. 1977) (en banc).

34. *Wilson*, 777 F.2d at 1249.

35. 190 U.S. 340 (1902).

36. *Id.* at 353.

37. 196 U.S. 68 (1904).

It is urged that the amendment of the law made by the act of February 5, 1903, excepting from the operation of a discharge in bankruptcy a decree for alimony due or to become due, or for the maintenance and support of the wife and minor children, is a legislative recognition of the fact that, prior to the passage of the amendment, judgments for alimony would be discharged. In *Dunbar v. Dunbar*, 190 U.S. 340, cited *supra*, it was said that this amendment, while it did not apply to prior cases, may be referred to for the purpose of showing the legislative trend in the direction of not discharging an obligation of the bankrupt for the support and maintenance of wife and children. The amendment may also have been passed with a view to settling the law upon this subject and to put at rest the controversies which had arisen from the conflicting decisions of the courts, both State and Federal, upon this question. Indeed, in view of the construction of the act in this court in *Audubon v. Shufeldt*, *supra*, it may be said to be merely declaratory of the true meaning and sense of the statute. *United States v. Freeman*, 3 How. 556; *Bailey v. Clark*, 21 Wall. 284, 288; *Cope v. Cope*, 137 U.S. 682, 688.³⁸

The *Wilson* court's handling of the 1984 amendment to section 525 is inconsistent with these two decisions. Equally troubling is its attitude toward section 525 as originally enacted. It does not follow that the imposition of statutory obligations on governmental units is inconsistent with the imposition of the same, or similar obligations on private entities.³⁹ A negative inference that private parties are free to discriminate is possible but by no means compelled by the statutory language.⁴⁰

Decisions like *Wilson* should cause us to question whether it was wise for the Bankruptcy Commission to suggest a codification of *Perez*. It is highly unlikely that section 4-508 was needed to protect *Perez* from being explicitly overruled. This century has witnessed a gradual increase in the scope of debtor protection provided by the bankruptcy laws. *Perez* is consistent with

38. *Id.* at 76-77.

39. See F. DICKERSON, *supra* note 6.

40. Other sections of the Bankruptcy Code suggest the possibilities of negative inferences. Section 510(c) allows the subordination of claims to other claims and interest to other interests. Possible negative inference: a claim cannot be subordinated to an interest. Section 541(b)(2) excludes from property of the estate an interest as a lessee of nonresidential real property if the lease expired before bankruptcy. Possible negative inference: property of the estate includes interests under expired residential leases. Section 707(b) authorizes dismissal of a Chapter 7 proceeding for "substantial abuse" if the petitioners debts are primarily consumer obligations. Possible negative inference: the court has no power to dismiss a petition for the same reason when the debts are primarily business obligations. Section 1322(b)(1) authorizes separate classification and different treatment of claims for consumer debts where a codebtor exists. Possible negative inference: no separate classification and treatment of any claim is permissible where there is no codebtor.

The first negative inference is completely unacceptable. It would eliminate the well established doctrine of equitable subordination. The other three possibilities are less dramatic, but still controversial. The rejection of any of these negative inferences does not conclusively establish that a negative inference from § 525 is unwarranted. It does, however, suggest that the merits of each negative inference should be evaluated.

Once this conclusion is reached, an examination of legislative history and context cannot be avoided.

that increase and, once the Supreme Court took the extraordinary step of overruling two decisions directly on point, the possibility of a retreat from the precise holding of that case remained highly unlikely. Section 4-508 would have made sense as an attempt to increase dramatically the collateral consequences of the bankruptcy discharge, but it appears that it was not so intended by the Commission.⁴¹ Nor does it appear that the proposed section was necessary to convince courts to go beyond the exact facts of the holding in *Perez* and condemn other discriminatory activity by governmental units. There is little case authority dealing with governmental discrimination in the period between *Perez* and the effective date of the new Code. What there is suggests that courts were willing to read *Perez* as condemning activity which had been permissible for public entities under the precedents which it repudiated.⁴²

On the other hand, the negative consequences of codification, so well demonstrated in the *Wilson* opinion, became apparent shortly after codification was proposed. In *McLellan*, for instance, the Fifth Circuit, in rejecting a challenge to a bankruptcy-based dismissal from private employment under pre-Code law, offered these comments concerning the Commission's proposal:

We find no law which restrains MPL from firing an employee because he has filed a petition in voluntary bankruptcy. No statutory provision shields a bankrupt from later economic consequences visited upon him by private individuals, whether acting alone or in concert. A thorough examination of the Bankruptcy Act and its legislative history discloses no explicit provision or intent to prohibit discriminatory action against an individual on the basis of his declaring bankruptcy. In addition, no such Congressional intent can be reasonably inferred from the statute as it is now enacted. Nor can such a right be legitimately implied from the Constitution's Bankruptcy Clause itself. As has been pointed out, that empowering provision speaks only in discretionary terms and does not afford any individual a right which Congress has not specifically legislated.

This is not to say that Congress and others have been unmindful of discrimination practiced against bankrupts. Both of the proposed new Bankruptcy Acts—that drafted by the Commission on the Bankruptcy Laws of the United States and that by the National Conference of Bankruptcy Judges—have identical section 4-508's:

A person shall not be subjected to discriminatory treatment because he, or any person with whom he is or has been associated, is or has been a debtor or has failed to pay a debt discharge in a case under this title.

It would be inappropriate for us here to resolve whether *McLellan* would have been protected by this proposed provision had it been law

41. See *supra* note 18.

42. See, e.g., *Grimes v. Hoschler*, 12 Cal. 3d 305, 525 P.2d 65, 115 Cal. Rptr. 625 (1974); *Rutledge v. City of Shreveport*, 387 F. Supp. 1277 (W.D. La. 1975); *In re Loftin*, 327 So. 2d 543 (La. App. 1976).

at the time of his firing. Our intent is merely to show that Congress is only now considering what protection, if any, a bankrupt should have from discriminatory treatment. No statutory protection has been afforded in the past and none presently shelters this unfortunate class.⁴³

Today, it no longer matters whether or not the Bankruptcy Commission acted wisely in putting forward section 4-508. Codification has occurred and the only important remaining issue is how section 525 and the *Perez* doctrine interact to further the rehabilitative objectives of bankruptcy law. It is clear that many courts have viewed section 525 as the sole source of rehabilitation policy.⁴⁴ The legislative context of section 525 clearly indicates that this is too narrow a view. Congress did not intend to limit *Perez*, but only to make sure that credit extending practices were not subjected to scrutiny by the bankruptcy court. *Perez* remains as a possible precedential base for the development of a rehabilitation policy which balances the interests of the debtor against those of private parties. At the same time, the debtor who looks beyond the words of section 525 must be prepared for the citation of *McLellan*. The reluctance to condemn private party discrimination is based both upon a misreading of the legislative record and the deference some courts⁴⁵ have given to the *McLellan* opinion, the first post-*Perez* decision which refuses to condemn a discriminatory discharge by a private entity. To

43. *McLellan*, 545 F.2d at 929-30 (en banc). It also has been erroneously suggested that the narrower scope of § 525 was the result of political compromise. See, e.g., Taub, *Section 525—Protection Against Discriminatory Treatment*, 1985 ANN. SURV. OF BANKR. LAW 569, 571 (1985); *In re Barbee*, 14 Bankr. 733 (Bankr. E.D. Va. 1981). A substantial misreading of the legislative record appears in *In re Neiheisel*, 32 Bankr. 146 (Bankr. D. Utah 1983) which was not a § 525 case. There, the court stated that:

The record of proposed bankruptcy legislation, beginning with the Commission's report in 1973 and ending with the Bankruptcy Reform Act of 1978, demonstrates that the fresh start doctrine has been a major force behind suggested reforms. But the theoretical aspirations of proposals to enhance the fresh start of debtors have been counterbalanced in reality by both creditors' demands for protection and by resistance to federal control of local affairs. Congress, after examining many proposals designed to further the fresh start, ultimately selected only some. A fresh start was provided but, in the words of Senator Thurmond, only "on a limited basis."

The Bankruptcy Code legislates many reforms favorable to a fresh start for debtors. Among these are expanded jurisdiction, a liberalized discharge, a broadened automatic stay, enhanced avoiding powers, new rights of redemption, and potent restrictions on post-bankruptcy treatment of discharge debtors. Exemptions, although quantum in category are left to the states, are made both easier to claim and harder to lose. These reforms have been called "an interlocking network of protections capable of assuring debtors a fresh start." *In the political give and take surrounding the Bankruptcy Reform Act, many proposals to enhance the fresh start were lost to compromise, including proposals to ban reaffirmations, eliminate the false financial statement to discharge and extend by statute the prohibition of post-discharge discrimination to private parties.*

Id. at 161 (footnotes omitted) (emphasis added).

44. See cases cited *supra* note 7.

45. E.g., *Wilson*, 777 F.2d at 1246; *Ryan v. Ohio Edison Co.*, 611 F.2d 1170 (6th Cir. 1979); *Barbee*, 14 Bankr. at 733.

the extent that the debtor looks to *Perez* for support, *McLellan* is an obstacle to relief, but a less persuasive precedent than it initially appears to be.

The employee in *McLellan* was discharged for commencing a voluntary bankruptcy, an act which violated a company rule. His union refused to assist him in seeking reinstatement. He subsequently commenced an action in federal court alleging a conspiracy in violation of 42 U.S.C. § 1985(3).⁴⁶ The Fifth Circuit reversed the district court's dismissal of the complaint.⁴⁷ The court, en banc, reached the opposite conclusion and affirmed the dismissal.⁴⁸ It reasoned that there was no violation of the statute absent a conspiracy to do an act which was illegal independent of section 1985(3) itself. The independent illegality requirement was not satisfied since the court found no law prohibiting a bankruptcy-based discharge.⁴⁹ Neither plaintiff nor defendants made any reference to *Perez* in their briefs⁵⁰ although it was

46. The statute, under the title of "Depriving persons of rights or privileges," reads in part:

If two or more persons in any State or Territory conspire or go in disguise on the highway or on the premises of another, for the purpose of depriving, either directly or indirectly, any person or class of persons of the equal protection of the laws, or of equal privileges and immunities under the laws; or for the purpose of preventing or hindering the constituted authorities of any State or Territory from giving or securing to all persons within such State or Territory the equal protection of the laws; or if two or more persons conspire to prevent by force, intimidation, or threat, any citizen who is lawfully entitled to vote, from giving his support or advocacy in a legal manner, toward or in favor of the election of any lawfully qualified person as an elector for President or Vice President, or as a Member of Congress of the United States; or to injure any citizen in person or property on account of such support or advocacy; in any case of conspiracy set forth in this section, if one or more persons engaged therein do, or cause to be done, any act in furtherance of the object of such conspiracy, whereby another is injured in his person or property, or deprived of having and exercising any right or privilege of a citizen of the United States, the party so injured or deprived may have an action for the recovery of damages occasioned by such injury or deprivation, against any one or more of the conspirators.

42 U.S.C. § 1985(3) (1982).

47. *McLellan v. Mississippi Power & Light Co.*, 526 F.2d 870 (5th Cir. 1976), *reh'g en banc granted*.

48. *McLellan*, 545 F.2d at 919 (en banc).

49. The independent illegality requirement is criticized in Comment, *Private Conspiracies to Violate Civil Rights*, 90 HARV. L. REV. 1721 (1977) and Comment, *Civil Rights—Section 1985(3)—Independently Illegal Act by Defendant Necessary Element of Cause of Action Under 42 U.S.C. Section 1985(3)*, 9 RUT.-CAM. L.J. 187 (1977).

50. Both plaintiff and defendant submitted two briefs, one when the case was originally argued and one for the rehearing *en banc*. Plaintiff never developed, to any significant extent, the idea that effective rehabilitation policy required a prohibition on bankruptcy-based discharges by *all* employers. In his first brief, he asserted that:

[defendant] should not be permitted to discharge Appellant for taking a voluntary bankruptcy. The Company should have to bear the burden of proving that voluntary bankruptcy on the part of one of its employees has a detrimental effect on the Company. Where an employer's conduct is demonstrably destructive of employee rights and is not justified by the service of significant or important business ends, the employer should be held liable for the resultant damages to the employee.

Since the right to labor is protected by the Fourteenth Amendment and numerous

cited by the Fifth Circuit in its original opinion.⁵¹ Presumably responding to this citation, the court rejected *Perez* as a foundation for satisfying the independent illegality of section 1985(3) in a most casual footnote:

Perez v. Campbell, 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233 (1971), is of no help to McLellan. In *Perez* a state statute which provided that a bankruptcy discharge did not erase a judgment against a negligent automobile driver was struck down under the Supremacy Clause, U.S.Const. art. VI, cl. 2. Here, of course, purely private action is involved.⁵²

This brief statement, unaccompanied by an explanation, has been cited several times in support of the view that private parties enjoy complete freedom to impede the functioning of the bankruptcy process.⁵³ It is, however, not very persuasive. There is no citation of authority or any attempt to justify such a distinction between private and public action.⁵⁴ The footnote

guaranties of state constitutions, one cannot be deprived of such right by arbitrary and capricious acts on the part of an employer.

If in fact Appellee Mississippi Power & Light Company has a policy of firing all employees who file voluntary bankruptcy proceedings, it should be required to prove that such a policy serves any significant or important business ends.

Brief for Plaintiff-Appellant, at 11, *McLellan*, 526 F.2d at 870 (No. 73-3226).

The focus of the argument shifted from labor policy to vaguely articulated bankruptcy policy in the second brief:

When McLellan filed the petition in bankruptcy, he was engaged in activity protected by Article 1, Section 8, Clause 4, and 11 U.S.C. §27, and the actions taken by MPL and the unions was unreasonable and violated his constitutional and statutory rights. The discharge of McLellan from his job under the circumstances of this case was done pursuant to an impermissibly invidious discrimination, and is remediable under §1985(3).

Brief for Plaintiff-Appellant, at 20, *McLellan*, 545 F.2d at 919 (No. 73-3226)(en banc).

51. *McLellan*, 526 F.2d at 878.

52. *McLellan*, 545 F.2d at 930 n.57 (en banc). *McLellan* is one of a number of lower court decisions which refused to extend the protection afforded by section 1985(3) to various classes. See Note, *Civil Rights Conspiracies: Section 1985(3) After Carpenters v. Scott*, 50 Mo. L. Rev. 174, 178 (1985). The Fifth Circuit was clearly more interested in limiting the application of section 1985(3) than in considering the implications of the *Perez* decision. In such a context, the casual nature of the footnote is understandable, even if it is not laudable. Subsequently, the Supreme Court in *United Brotherhood of Carpenters Local 610 v. Scott*, 463 U.S. 825 (1983) narrowly construed section 1985(3):

[W]e find no convincing support in the legislative history for the proposition that the provision was intended to reach conspiracies motivated by bias towards others on account of their *economic* views, status or activities. Such a construction would extend § 1985(3) into the economic life of the country in a way that we doubt the 1871 Congress would have intended when it passed the provision in 1871.

Id. at 837. As so construed, this section does not proscribe bankruptcy-based discrimination even if the requisite state involvement exists. The *Scott* holding does not, however, prevent Congress from acting as it has in § 325 to prohibit such discrimination, nor does it prevent further judicial elaboration of the *Perez* doctrine.

53. See cases cited *supra* note 45.

54. In bankruptcy law, as elsewhere, there is a continuing debate over the degree of deference to be accorded state governmental activity. See, e.g., *Barnette v. Evans*, 673 F.2d 1250 (11th Cir. 1982) (error to issue injunction against state criminal proceeding). To the extent that notions of federalism are relevant in determining the limits of permissible discrimination, a court should be less reluctant to condemn private activity than to interfere with the administration of a state motor vehicle licensing law.

reference to *Perez* suggests only a factual difference, a distinction without substance. It is certainly true that *Perez* involved state activity. It is also true that, in most instances, the primacy of bankruptcy policy will be asserted in the context of a clash between state and federal statutes.⁵⁵ But this need not always be so. The prejudice to the debtor can arise from the failure of state common law to take proper notice of the demands of bankruptcy policy. Judicial decisions are equally subject to displacement by federal law. There was, for example, no invocation of state created statutory rights in *Local Loan Co. v. Hunt*.⁵⁶ *Hunt* concerned a private party's attempt to enforce a lien in accordance with the common law of Illinois. Notwithstanding this fact, the United States Supreme Court had no difficulty in maintaining the supremacy of bankruptcy law.⁵⁷

There is nothing in either precedent, logic or history which supports *McLellan's* scanty footnote conclusion that private party discrimination is permissible and beyond the reach of the protective orders which 11 U.S.C. § 105 (1982) now authorizes the bankruptcy court to issue.⁵⁸ The distinction between private and public (state) action is well established in constitutional

55. The conflicting statute ordinarily authorizes governmental activity as in *Perez v. Campbell*, 402 U.S. 637 (1971). A state statute, however, also will be invalid if it authorizes private activity which conflicts with bankruptcy policy. *Cf. Goldstein v. Colombia Diamond Ring Co., Inc.*, 366 Mass. 835, 323 N.E.2d 344 (1975) (receiver cannot avoid preference pursuant to state law).

56. 292 U.S. 234 (1934).

57. *See also Harris v. Manufacturer's Nat'l Bank of Detroit*, 457 F.2d 631 (6th Cir. 1972). Debtor and his wife owned property as tenants by the entirety. Under Michigan law, a joint judgment against husband and wife could be satisfied out of this property despite the fact that the husband had received a bankruptcy discharge. The Sixth Circuit held that the Michigan authorities were incompatible with the result in *Perez* and rejected the contention that only state statutes were affected by that decision. The court noted that:

Although *Fetter* and the present case involve a conflict between state case law and the Bankruptcy Act, whereas *Perez* involved a conflicting state statute, the Supreme Court's adherence to the overriding purpose of Section 17 of the Bankruptcy Act in *Perez* fully supports the *Fetter* decision and its applicability to the present case. We believe that Michigan case law at issue here presents a more direct conflict with Section 17 than did the Arizona statute in *Perez*.

Id. at 634.

58. *Ryan*, 611 F.2d at 1170, refuses to infer a private cause of action (damages and injunctive relief) from the provisions of the Bankruptcy Act of 1898. In *Ryan*, the defendant was a public utility and the opinion fails to state clearly whether the objection to recovery was the defendant's status or the failure of Congress to explicitly provide a remedy for discriminatory activity. 11 U.S.C. § 105 (1982) speaks directly to the latter point and permits the court to grant an appropriate remedy if the discriminatory act is improper. *See e.g., In re Amber Lingerie, Inc.*, 30 Bankr. 736 (Bankr. S.D.N.Y. 1983) (injunction against cancellation of insurance policy). *Amber*, in addition, holds that the antidiscrimination rule itself is derived from 11 U.S.C. § 105 (1982) and fails to mention 11 U.S.C. § 525 (1982). To the same effect, *see In re Blackwelder Furniture Co.*, 6 Bankr. Ct. Dec. (CRR) 1337 (Bankr. W.D.N.C. Oct. 7, 1980) (refusal to sell goods to Chapter 11 debtor). It would be preferable to base a finding of impermissible discrimination upon either 11 U.S.C. § 525 (Supp. III 1985) or *Perez*. *See United States v. Sutton*, 786 F.2d 1305 (5th Cir. 1986) (11 U.S.C. § 105 (1982) "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law or constitute a roving commission to do equity.") *Id.* at 1308.

adjudication.⁵⁹ A reading of the cases discussing *Perez* and section 525 leaves one with the impression that some courts, without openly acknowledging the fact, have transferred this distinction over to a completely unrelated area of inquiry.⁶⁰ As a result, private actors have been given greater freedom than public entities to interfere with the operation of the bankruptcy process. This Article maintains that private and public entities should be governed by the same rules. Accordingly, a debtor who finds no solace in the express terms of section 525 should still be entitled to the protection against discriminatory activity which *Perez* affirms is an integral part of bankruptcy policy.

III. IMPLEMENTATION OF THE *PEREZ* DOCTRINE

No court has yet suggested that there is some functional distinction between public and private discrimination which warrants application of different legal rules.⁶¹ Indeed, the failure of reported decisions to address this matter is somewhat puzzling. Perhaps courts have seized upon the public-private dichotomy because it is an easy way to avoid confronting what is perceived to be a more difficult issue, the question of what types of private discriminatory activity should be prohibited. Much litigation with governmental units involves challenges to withdrawal of entitlements—driver's licenses and the like, and the remedy for impermissible discrimination often will not force the actor into a new or continuing relationship with the debtor. Private party litigation, on the other hand, is likely to contain a higher percentage of cases in which it is asserted that there has been an improper refusal to deal with the debtor. An injunctive remedy for discrimination will link the private actor and the debtor in a continuing relationship. Both contract⁶² and bankruptcy law⁶³ recognize that certain relationships are highly personal, involving performance standards not readily susceptible to legal scrutiny, and abstain from mandating that such relationships continue absent the consent of both parties. The unwillingness to extend the *Perez* doctrine to

59. See, e.g., 2 R. ROTUNDA & J. NOWAK, TREATISE ON CONSTITUTIONAL LAW § 14.4 (1986).

60. Cf. Klare, *The Public/Private Distinction in Labor Law*, 130 U. PA. L. REV. 1358, 1362-63 (1982) (noting a tendency to apply public law norms to private employment relationships). The best example of this transference is found in *McLellan*. Counsel for Appellant (see *supra* note 50) and the court in *McLellan* both blurred the distinction between constitutional doctrine and bankruptcy policy.

61. Compare Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1428-30 (1985) which notes the distinction between public and private action and questions whether exercise of the discharge right should be made less burdensome with Rendlemen, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C.L. REV. 723, 754-56 (1980) which suggests that an amendment of § 525 is needed.

62. RESTATEMENT (SECOND) OF CONTRACTS §§ 317(2)(a), 318(2), 319(2) (1979).

63. 11 U.S.C. § 365(c)(1)-(2) (Supp. III 1985); *In re Tonry*, 11 Bankr. Ct. Dec. (CRR) 801 (5th Cir. Feb. 6, 1984) (trustee may not assume attorney's obligation under contingent fee contract).

private party discrimination no doubt, at least to some extent, reflects a feeling that disputes arising out of refusals to deal are not particularly amenable to judicial resolution.

It is predictable that wholesale extension of *Perez* protection to private parties will provoke a flurry of litigation. Insurers will be charged with wrongful refusal to provide or renew insurance. Vendors of goods and services will complain that their markets have been improperly restricted. Vendees will demand the right to buy what they need. Some courts can be expected to continue to resist assuming any responsibility for resolving such disputes (absent an explicit directive from Congress) unless it can be shown that judicial intervention need not result in a quagmire of subjective judgments. The risk of becoming involved in resolution of this type of dispute, if it indeed exists, is not substantial. A simple approach is possible which will provide effective protection for many debtors while not requiring more than a cursory inquiry into the facts of the case. Discrimination should be condemned when the private party cannot offer any credible, independent justification for what it is doing, especially when it will suffer no loss if forced to deal with the debtor.

There is no indication in any case law, or in the language of section 525, that the events which lead up to the filing of the petition need be forgotten. Financial misfortune is a fact. Bankruptcy can only provide a vehicle for some debtors to move forward after the unfortunate event. The determination of whether private party discrimination unduly interferes with the bankruptcy process requires a weighing of interests. It can be argued that the debtor's right to a discharge or a fair chance at proposing a reorganization plan must be balanced against the other party's right to choose those with whom it does business. No true clash of interests exists and no delicate balance need be struck, however, when the nondebtor insists that the bankruptcy itself, completely divorced from the facts which led up to bankruptcy, or from what is then going on in the proceeding, supports a refusal to deal. Whenever there is a nexus between bankruptcy and the discriminatory activity, the activity is suspect. Consider the following possible fact situations:

Example 1: Debtor, a furniture retailer, has obtained confirmation of a Chapter 11 plan. Much of its business is dependent upon its ability to carry inventory made by certain manufacturers whose furniture is particularly well respected by the public. A substantial portion of these manufacturers refuse to deal with the debtor, even on a cash basis, and it is shown that the prospects for successful post-confirmation operation are minimal unless a normal flow of goods can be reestablished. The recalcitrant manufacturers offer no justification for their refusal to deal. It is entirely proper and consistent with bankruptcy policy to require sales to the debtor on a cash basis even though the manufacturers are private parties.⁶⁴

64. The facts of this example are based on *In re Blackwelder Furniture Co.*, 6 Bankr. Ct. Dec. (CRR) 1337 (Bankr. W.D.N.C. Oct. 7, 1980). A refusal to engage in cash transactions

Example 2: Debtor, a clothing manufacturer, is the holder of a fire insurance policy issued by Reliance Insurance Company. The \$10,000 annual premium was paid in advance and before the Debtor filed its Chapter 11 petition. During the course of the proceeding, Reliance attempts to exercise its option to cancel the insurance policy upon thirty days notice, providing no reason for the cancellation. Equivalent coverage is available elsewhere at a cost of \$35,000, a sum beyond the debtor's means.⁶⁵ It is entirely appropriate for the court to infer that bankruptcy is the basis for the cancellation and to issue an injunction pursuant to section 105 of the Bankruptcy Code.⁶⁶

*Example 3.*⁶⁷ Having been denied the right to cancel the policy, Reliance simply refuses to renew it at the expiration of the policy term. Again, no explanation is provided. The bankruptcy court should order continuation of insurance coverage on the same terms as those available to other similarly situated purchasers of insurance who are not involved in bankruptcy proceedings.⁶⁸

In each of these three examples, the nondebtor party has acted in a way that will make rehabilitation more difficult and has not suggested any disadvantage in a continuing relationship with the debtor. There is no inconvenience to the private entity worthy of legal protection when that party cannot point to even the possibility of prejudice in being forced to deal with the debtor. This point is well illustrated by a 1983 decision, *In re Son-Shine Grading, Inc.*,⁶⁹ involving North Carolina's refusal to deal with a Chapter 11 debtor. In that case the state removed the debtor from its list of qualified bidders simply because the debtor was involved in bankruptcy proceedings. The district court, in the course of granting a permanent injunction against this practice, offered these observations:

also violates 11 U.S.C. § 362(a)(6) (1982) when it represents an attempt to collect prepetition claims. *In re Sportfame of Ohio, Inc.*, 40 Bankr. 47 (Bankr. N.D. Ohio 1984).

65. An increase in premium attributable to bankruptcy and outright cancellation are subject to the same criticism. See *In re Amber Lingerie, Inc.*, 30 Bankr. 736 (Bankr. S.D.N.Y. 1983).

66. The facts of this example are taken from *Amber Lingerie*, 30 Bankr. 736. In that case the court held that cancellation was improper—even though the insurance company asserted that bankruptcy might lead to an increased risk of arson. See also *In re Cahokia Downs, Inc.*, 5 Bankr. 529 (Bankr. S.D. Ill. 1980).

67. Assume the same fact pattern as in *example 2*.

68. *In re Garnas*, 38 Bankr. 221 (Bankr. D.N.D. 1984) invoked 11 U.S.C. § 365(e)(1) (1982) to prevent nonrenewal of debtor's insurance policy. The court reasoned that, where there is a practice of renewal, a continuing executory contract exists despite the fact that the policy is written for a one year period. The fact of bankruptcy was the sole (and impermissible) basis for nonrenewal. *In re Diamond & Gold Connection, Inc.*, 54 Bankr. 917 (Bankr. D. Mass. 1985) disapproved of the *Garnas* decision and also refused to prohibit nonrenewal under 11 U.S.C. § 525 (Supp. III 1985). No court, in fact, has held that § 525 requires renewal of contract. See *In re Heaven Sent, Ltd.*, 50 Bankr. 636 (Bankr. E.D. Pa. 1985) (refusal to continue coverage on Chapter 11 debtor); *In re Bogey's Barn Ltd.*, 47 Bankr. 555 (Bankr. S.D. Fla. 1985); *In re Heaven Sent, Ltd.*, 37 Bankr. 597 (Bankr. E.D. Pa. 1984) (refusal to renew coverage); *Cahokia Downs*, 5 Bankr. at 529 (dictum); *In re Nashville White Trucks, Inc.*, 5 Bankr. 112 (Bankr. M.D. Tenn. 1980) (truck dealership franchise); but cf. *In re Olson*, 38 Bankr. 515 (Bankr. N.D. Iowa 1984) (refusal to continue providing medical services probably violates § 525).

69. 27 Bankr. 693 (Bankr. E.D.N.C. 1983).

The State of North Carolina has argued extensively that if the relief requested by the Debtor is granted that it will be forced to contract with irresponsible debtors. Such is not the case. The Debtor has not complained about the financial requirements for bidding on highway projects other than the provision which prevents it from bidding solely because of its filing a bankruptcy petition. Furthermore, the Debtor is not requesting this Court to tell the State of North Carolina what financial requirements may or may not be required of its bidders. However, if a contractor can meet all bidding requirements of other contractors except for the fact that it has a bankruptcy petition pending, then it becomes very apparent that the State of North Carolina is arbitrarily assuming that a bankrupt debtor cannot meet its reasonable requirements for bidding on state highway projects. In many cases, a debtor under Chapter 11 may be much better able to perform its contracts than a contractor not in bankruptcy since the current operating profits of the debtor-contractor are not required for immediate use in the payment of pre-petition debts.⁷⁰

Refusal to deal becomes no more reasonable or acceptable when the discriminatory action originates with a private party instead of the State of North Carolina. The remedy for such an unjustified refusal becomes no more controversial or impractical when relief is granted against a private party rather than against a governmental unit. The approach adopted by the North Carolina court can be used to remedy many forms of discrimination outside the literal language of section 525.

There is nothing extraordinary in the view that public and private entities do not enjoy complete freedom to decide whether or not they will transact business with debtors. Section 365⁷¹ and its predecessor, section 70(b) of the Bankruptcy Act of 1898,⁷² have, for many years, compelled the continuation of existing relationships beyond the moment when the petition is filed. Section 365 denies effect to clauses which purport to terminate contractual relationships simply because a bankruptcy has occurred.⁷³ The rights of the nondebtor party are restricted unless some real prejudice arising out of a continuing relationship can be demonstrated. Protection against possible harm is provided by placing limits on the right to demand performance under the contract.⁷⁴ Section 525 and the *Perez* doctrine can also be used to reconcile the interests of the parties, although protection of the debtor will take a different form.

It may be argued that it is significantly easier and, therefore, more appropriate to prevent the rupture of an existing relationship under section

70. *Son-Shine*, 27 Bankr. at 695.

71. 11 U.S.C. § 365 (1982).

72. 11 U.S.C. § 70(b) (repealed effective 10-1-79).

73. 11 U.S.C. § 365(b)(2), (e)(1)(a) (1982).

74. The trustee who wishes to assume and assign an executory contract, for example, is required to provide "adequate assurance of future performance." 11 U.S.C. § 365(f)(2)(b) (1982).

365 than to protect a future relationship under section 525. This is not true. Sound bankruptcy policy requires judicial intervention in each instance. If the obstacle to rehabilitation exists, it makes no difference whether it proceeds from an inability to maintain an old relationship or establish a new one. The remedies available under section 365 and section 525, of course, are quite different. Section 365 protects what already exists. Section 525 can only provide the debtor with a fair opportunity to create a new relationship. The North Carolina district court excluded the fact of bankruptcy from the bargaining process. It did not guarantee that the bargaining process would produce what the debtor required. A great advance in debtor protection, nevertheless, would be achieved if all courts similarly insisted that private parties do business with the debtor or justify their negative reactions to the debtor's involvement in bankruptcy proceedings.⁷⁵

There also will be cases in which it is unmistakably clear that the nondebtor party was acting without reference to the fact of bankruptcy. *In re Alessi*⁷⁶ was just such a case. In *Alessi*, the debtor's application for a racing license was denied pursuant to Rule 3.08 of the Illinois Racing Board which states that "[a]ny participant who shall accumulate unpaid obligations, or default in obligations, or issue drafts or checks that are dishonored, or payment refused, or otherwise display financial irresponsibility reflecting on his experience, character or general fitness shall be subject to refusal, suspension or revocation of license."⁷⁷

The Board made specific findings concerning the Alessis' conduct and financial condition, none of which were related to their involvement in a bankruptcy proceeding. The Board, for example, found that "[t]he accumulation of unpaid obligations by Alessi in the racing industry, especially the debts to persons for whom Alessi has driven and with whom he has owned horses, subjects Alessi to influence and power by those persons and endangers the integrity of the sport of horse racing."⁷⁸ Bankruptcy Judge Merrick had no difficulty in concluding that the denial of permission to race was not a violation of section 525. This result clearly was correct because there was no demonstrable nexus between the occurrence of bankruptcy and the action of the racing board. Activity does not impermissibly interfere with rehabilitation if it can be justified without reference to the fact that a bankruptcy proceeding has been commenced.

There will be cases falling in between the extremes of *Son-Shine* and *Alessi* in which bankruptcy and non-bankruptcy justifications for discrimination are intertwined. The following examples illustrate this point:

75. 11 U.S.C. § 525 (Supp. III 1985) uses the term "solely" to express the prohibited relationship between action and bankruptcy.

76. 7 Bankr. Ct. Dec. (CRR) 1037 (Bankr. N.D. Ill. June 24, 1981).

77. Quoted in *Alessi*, 7 Bankr. Ct. Dec. (CRR) at 1038.

78. *Alessi*, 7 Bankr. Ct. Dec. (CRR) at 1039.

Example 4: Debtor, involved in Chapter 11 proceedings, is unsuccessful in obtaining a construction contract with Owner even though it is the low bidder. In response to Debtor's request for an injunction prohibiting it from awarding the contract to the next lowest bidder, Owner argues that its action is justified because it fears a conversion to Chapter 7 and wishes to avoid the expense and inconvenience of locating a replacement. The desire to deal with a responsible and financially stable contractor is a legitimate non-bankruptcy justification for choosing another bidder. It is the bankruptcy process itself, however, which is responsible for the fear of instability.⁷⁹

An injunction should issue. Owner has acted in a discriminatory manner. Financial instability has various causes. Owner is not entitled to single out the risk of conversion to Chapter 7 and ignore the other factors which can cause a successful bidder to default. It can obtain adequate protection for itself by requiring that all bidders meet certain financial requirements.⁸⁰

Example 5: Reliance Insurance Company⁸¹ is now back with a second justification for refusing to issue a new policy. The debtor has invoked section 1113 and rejected its collective bargaining agreement. Reliance asserts that some employees are very upset and there is an unacceptable risk of arson. An increased risk of arson would certainly be an appropriate justification for refusal to issue a policy — if the risk were not associated with an action authorized by the Bankruptcy Code.⁸²

The solution proposed for *example 4* will not work here. No reasonable alternative exists.⁸³ In *example 5* it will be necessary to balance Reliance's freedom to deal with customers of its choice against Debtor's need for insurance. As the consequences of Reliance's failure to insure were more severe, the case for compelling issuance of a policy becomes stronger.⁸⁴ Some courts may consider excusing Reliance upon a showing of subjective good faith. Arguably, this is not proper when applying the *Perez* doctrine. Justice White, in that case, took the position that the discriminatory legislation was invalid even if the legislature had another non-discriminatory objective in mind.⁸⁵ This suggests that the motive of the insurer is also irrelevant.⁸⁶ Yet there

79. This example is suggested by the facts of *In re Marine Elec. Ry. Prods. Div., Inc.*, 17 Bankr. 845 (Bankr. E.D.N.Y. 1982).

80. See *Son-Shine*, 27 Bankr. at 693

81. See *supra* text accompanying note 67 (*example 3*).

82. Compare the facts of *Amber Lingerie*, 30 Bankr. at 736.

83. Reliance's underwriting department will have to decide whether to assume the risk of arson. There is no way to broaden the decision so as to divorce it from the fact that a bankruptcy proceeding is in progress. Reliance may decide to insure at an increased premium. The premium enhancement is open to the same type of challenge since it also refers to the fact of bankruptcy.

84. Debtor's case is weak if it can obtain insurance elsewhere at a minimal increase in premium. Reliance's case is weak if the reorganization cannot go forward without insurance and Reliance is the only available source.

85. See *supra* text accompanying note 13.

86. The opinions in *Marine Elec.*, 17 Bankr. at 845, *Amber Lingerie*, 30 Bankr. at 736, and *Cahokia Downs*, 5 Bankr. at 529, all exhibit skepticism that any factor other than the existence of a bankruptcy proceeding prompted the discriminatory act. It is possible that Justice

may be cases in which it is unreasonable to ask Reliance to assume this insurance risk, a possibility that the Supreme Court did not have to consider. The *Perez* doctrine is not yet fully matured. The best way to continue its development is through a careful assessment of how a decision to permit or condemn discriminatory action will affect the business operations of both parties.

CONCLUSION

Perez and its statutory offspring provide protection against some adverse consequences of bankruptcy and assist debtors who wish to continue as productive members of society. There are other effects if a proceeding is commenced under Chapter 11 or, to a lesser extent, Chapter 13. The *Perez* rule assists those who benefit when the debtor is able to avoid liquidation—creditors, employees, and shareholders. The prohibition against discriminatory activity reinforces Congress' control of the bankruptcy process, preventing disagreement with the objectives of bankruptcy law from flowering into obstruction. In this respect, the *Perez* rule has much in common with the automatic stay.⁸⁷

It is likely that a hesitancy to interfere with private decisions concerning future relationships has prompted some judges to adopt a cautious attitude toward non-governmental discrimination. Respect for the principle of private autonomy in contract formation, while important, need not always be controlling. Particular circumstances will, directly or indirectly, force one party to deal with another in appropriate cases.⁸⁸ This Article has argued that bankruptcy is such an occasion and that both public and private discrimination can be prohibited with little or no inconvenience to the nondebtor party.

Negative inferences drawn from the codification of *Perez* and to a lesser extent, following the 1984 amendment⁸⁹ also have influenced judicial attitudes. There is nothing in the history of section 525 which justifies the belief

White's rejection of the legislative motive argument (*see supra* text accompanying note 13) was prompted by a similar skeptical view of the statutory objective. It is hard to believe that the Arizona legislature had anything in mind other than a disagreement with federal bankruptcy policy. It is also unlikely that a court would find that Reliance's refusal to insure was in good faith unless this refusal was consistent with its practice in regard to other situations in which it believed there was an increased risk of arson. *But cf.* Lam, *Cancellation of Insurance: Bankruptcy Automatic Stay Implications*, 59 AM. BANKR. L.J. 267, 276 (1985).

87. *See* 11 U.S.C. § 362 (Supp. III 1985). One has the sense, however, that the judicial implementation of the automatic stay rules has been much more creative than the decisions applying *Perez* and § 525. *See, e.g.*, *Commerzanstalt v. Telewide Sys., Inc.*, 790 F.2d 206 (2nd Cir. 1986) (automatic stay applies to appeal by debtor and cannot be waived by it since purpose of stay is also to protect creditors), *rev'd on other grounds*, 794 F.2d 763 (2d Cir. 1986); *In Re Reed*, 11 Bankr. 258 (Bankr. D. Utah 1981) (dumping of garbage on debtor's lawn violates stay and debtor may recover damages for mental distress).

88. Parties involved in labor negotiations, for example, have a duty to bargain in good faith. 29 U.S.C. § 158(d) (1982). *See generally*, E. FARNSWORTH, *CONTRACTS* § 3.26 (1982).

89. *See supra* text accompanying note 5.

that everything not prohibited by the statute must be permitted. Courts should accept the invitation found in both the House and Senate Reports⁹⁰ "to mark the contours of the anti-discrimination provision in pursuit of sound bankruptcy policy." As Professor Grant Gilmore reminds us, the codification of a legal rule is the beginning, not the end, of an evolutionary process:

Codification, we may conclude, is much more successful in abolishing the past than in controlling the future. The future will, by and large, take care of itself—if the courts won't, the legislatures will do whatever may be necessary. The true function of a codifying statute is to reduce the past to order and certainty—and, thus, to abolish it.⁹¹

In 1984, Congress acted to correct the narrow view that everything not prohibited by section 525 is permitted. This statute should now be sensibly interpreted so that further corrective legislation is unnecessary.

90. See *supra* note 9.

91. Gilmore, *On Statutory Obsolescence*, 39 U. COLO. L. REV. 461, 476 (1967).