UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
ALBANY DIVISION

IN RE:	)	CHAPTER 13
	)	CASE NO. 01-12537-JDW
KENNETH T. SMITH,	)	
	)	
DEBTOR.	)	
	)	
KENNETH T. SMITH,	)	ADVERSARY PROCEEDING
	)	NO. 03-1004-JDW
PLAINTIFF,	)	
	)	
VS.	)	
	)	
TOMMY GOODE and GEORGIA DEPARTMENT OF LABOR,	)	
	)	
DEFENDANTS.	)	

BEFORE

JAMES D. WALKER, JR.

UNITED STATES BANKRUPTCY JUDGE

COUNSEL

For Debtor: Cawthon H. Custer
Post Office Box 605
Albany, Georgia 31702-0605

For Defendants: W. Wright Banks, Jr.
40 Capitol Square, SW

Atlanta, Georgia 30334-1300

MEMORANDUM OPINION

This matter comes before the Court on the Georgia Department of Labor and Tommy Goode's (collectively "Defendants") motion to dismiss Debtor Kenneth T. Smith's complaint for injunction and contempt. This is a core matter within the meaning of 28 U.S.C. § 157(b)(2)(O). After considering the pleadings, the evidence, and the applicable authorities, the Court denies the motion and enters the following findings of fact and conclusions of law in conformance with Federal Rule of Bankruptcy Procedure 7052.

Findings of Fact

This case arises from a dispute between Defendants and Debtor regarding certain unemployment insurance benefits received by Debtor. On July 26, 2001, Georgia Department of Labor employee Tommy Goode swore out a criminal warrant against Debtor, alleging that Debtor had collected unemployment insurance benefits from the State of Georgia in violation of Official Code of Georgia § 34-8-256 (1998), which makes it a crime to "knowingly make[] a false representation or knowingly fail[] to disclose a material fact to obtain" such benefits. Debtor filed a Chapter 13 petition on December 21, 2001. The Labor Department filed a proof of claim in Debtor's bankruptcy case on January 14, 2002, claiming a debt based on fraud, but not asserting the amount of the debt. Debtor objected to the proof of claim on the grounds that it failed to offer any proof of fraud and failed to state the amount of the debt. The Court disallowed the claim by Order entered July 12, 2002. The Department then pursued its criminal warrant against Debtor.

Debtor filed a Motion to Enjoin the criminal action on November 12, 2002, alleging that Goode and the Department had him incarcerated on a criminal warrant on August 17, 2002, in an

effort to frustrate the purpose of bankruptcy and the automatic stay. Also on November 12, 2002, Debtor filed a Motion for Attachment for Contempt, alleging that the parties proceeded with the criminal action after receiving notice of the bankruptcy for the purpose of collecting a debt and thereby obtaining property of the bankruptcy estate.

At some point, the parties entered into settlement negotiations resulting in Debtor's agreement to repay those unemployment insurance benefits that Defendants alleged he had obtained through fraud. While Debtor was making payments, the Department did not pursue the criminal action. Although the agreement preceded the bankruptcy filing, it is unclear whether or not it also preceded the initial criminal warrant sworn out by Goode. Debtor eventually defaulted on his payments under the agreement and filed for bankruptcy. Only after these events did Defendants take any real steps to move the criminal case forward.

On February 10, 2003, Debtor sought to have his two motions converted to an adversary proceeding, and filed a Motion for Attachment for Contempt & Motion to Enjoin that reasserted the allegations made in the previous two motions. The Court ordered the conversion on February 13, 2003.

Debtor has alleged in the record that the criminal action was initiated solely to collect a debt and that Debtor cannot raise a "bad faith" defense based on debt collection motive in the state court. In addition, Debtor argues that by pursuing the criminal action, Defendants have violated the automatic stay. On February 28, 2003, Goode and the Labor Department filed a motion to dismiss on the ground that Debtor's complaint fails to state a claim upon which relief can be granted and that it is barred by sovereign immunity. The Court held a hearing on the issue on

April 21, 2003, and now denies Defendants' motion to dismiss.

Conclusions of Law

Sovereign Immunity

The Court begins with Defendants' argument that this proceeding is barred by sovereign immunity and finds the argument to be without merit. Pursuant to the Eleventh Amendment, the "Judicial power of the United States shall not be construed to extend to any suit . . . commenced or prosecuted against one of the . . . States by Citizens of another State" or by its own citizens. U.S. Const. Amend. XI; Hans v. Louisiana, 134 U.S. 1, 10, 10 S. Ct. 504, 505 (1890).[1] Section 106(a) of the Bankruptcy Code purports to abrogate the sovereign immunity of governmental units, including states.[2] The circuit courts are split as to whether Section 106(a) is constitutional as applied to the states, with the majority finding it unconstitutional. Nelson v. La Crosse County Dist. Atty., 301 F.3d 820, 832 (7th Cir. 2002); Mitchell v. Franchise Tax Bd. (In re Mitchell), 209 F.3d 1111, 1121 (9th Cir. 2000); Sacred Heart Hosp. of Norristown v. Pennsylvania Dep't of Pub. Welfare (In re Sacred Heart Hosp. of Norristown), 133 F.3d 237, 245 (3d Cir. 1998); Schlossberg v. Maryland (In re Creative Goldsmiths of Washington, D.C., Inc.), 119 F.3d 1140, 1147 (4th Cir. 1997); Department of Transp. & Dev. v. PNL Asset Mgmt. Co. LLC (In re Estate of Fernandez), 123 F.3d 241, 243 (5th Cir. 1997) (all holding that Congress may not abrogate state sovereign immunity). *Contra* Hood v. Tennessee Student Assistance Corp. (In re Hood),

[1] Debtor has not disputed that the Department of Labor is an agency of the State of Georgia covered by the Eleventh Amendment.

[2] "[S]overeign immunity is abrogated as to a governmental unit to the extent set forth in this section . . . ." 11 U.S.C.A. § 106(a) (West Supp. 2003).

319 F.3d 755, 762 (6th Cir. 2003) (holding that Congress may abrogate state sovereign immunity pursuant to its power under the Bankruptcy Clause). The Eleventh Circuit Court of Appeals has not decided the question.[3] However, it has considered the issue of waiver of state sovereign immunity in bankruptcy. Georgia v. Burke (In re Burke), 146 F.3d 1313 (11th Cir. 1998). Because this Court can dispense of the sovereign immunity claim by applying the law of waiver, it need not trudge through the quagmire of constitutional questions raised by Defendants' argument.

Regardless of whether Congress successfully abrogated state sovereign immunity or whether such immunity exists as to bankruptcy matters so as to be abrogated, a state can always waive what immunity it may have. Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 238 105 S. Ct. 3142, 3145 (1985). In Gardner v. New Jersey, the Supreme Court held that when a state files a claim in a bankruptcy case, it "waives any immunity . . . respecting the adjudication" of that claim. 329 U.S. 565, 574, 67 S. Ct. 467, 472 (1947). The Eleventh Circuit Court of Appeals began shaping the boundaries of the waiver effected by filing a claim in Burke. In that case, the court found that filing a claim subjected the state to adversary proceedings for violation of the automatic stay and violation of the discharge injunction. Id. at 1319. This is consistent with the

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[3] At the direction of the District Court, I held Section 106(a) to be unconstitutional as applied to the states in a opinion for the Southern District of Georgia. King v. Florida (In re King), 280 B.R. 767, 777 (Bankr. S.D. Ga. 2002). However, in dicta, I also set forth my reasons for believing that Section 106(a) is superfluous on the ground that the states ceded their sovereign immunity with respect to federal bankruptcy laws when they ratified the U.S. Constitution, which endows Congress with the power to pass uniform bankruptcy laws. Id. at 770-73. By invoking sovereign immunity, the states do violence to the Bankruptcy Code by undermining one of its central policies–putting all similarly situated creditors on a level playing field. Id. at 772-73. Allowing one creditor to thwart the scheme enacted by Congress threatens the effectiveness of the entire system. Id. at 773.

Supreme Court's observation in Gardner that, like all other creditors, when a state "invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance[, the state] must abide by the consequences of that procedure." 329 U.S. at 573, 67 S. Ct. at 472.

Defendants have argued that the adjudication of the state's claim in this case ended when the Court disallowed the claim, thus, effectively terminating the Court's jurisdiction over Defendants. However, as Burke demonstrated, the claims adjudication process consists of much more than mere allowance and disallowance of a claim. See Drivas v. Intuition, Inc. (In re Drivas), 266 B.R. 515, 522 (Bankr. M.D. Fla. 2001). And, once sovereign immunity has been voluntarily waived, it cannot be reinstated. Stanley v. Student Loan Servs., Inc. (In re Stanley), 273 B.R. 907, 911 (Bankr. N.D. Fla. 2002). In Burke the court stated that even after the bankruptcy case had been closed, "the bankruptcy court retained jurisdiction over the State in order to enforce the judgment it had entered as part of adjudicating the State's claim in the . . . bankruptcy case." 146 F.3d at 1319. In this case, the Court disallowed the Department's claim. Creditors whose claims have been disallowed are not free to collect the debt outside of bankruptcy. On the contrary, the automatic stay will enjoin any collection efforts until replaced by the discharge injunction. See 11 U.S.C.A. §§ 362(a), 524(a) (West 1993 & Supp. 2003). In a Chapter 13 case, Section 1328(a) expressly extends the discharge to disallowed claims. Id. § 1328(a) (West Supp. 2003). Although, as explained infra, this case is not about an automatic stay or a discharge injunction violation, it serves the same purpose–to prevent the Department from attempting to avoid the mandates of the Bankruptcy Code in order to collect a debt. Thus, the Court's consideration of this issue is well within the scope of sovereign immunity waiver as articulated in Burke.

Failure to State a Claim

Defendants' next ground for dismissal–failure to state a claim upon which relief can be granted–is made pursuant to Federal Rule of Civil Procedure 12(b)(6), made applicable to adversary proceedings under Federal Rule of Bankruptcy Procedure 7012(b). In evaluating such a motion, "a court must accept the allegations in the complaint as true, construing them in the light most favorable to the plaintiffs." White v. Lemacks, 183 F.3d 1253, 1255 (11th Cir. 1999). The Court has done so in setting out the findings of fact above. While the Court should "focus its analysis on the face of the complaint, . . . it may also consider any attachments to the complaint, matters of public record, orders, and items appearing in the record." Jones v. Mann (In re Jones), 277 B.R. 816, 819 (Bankr. M.D. Ga. 2001). "[U]nless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief[,]" the motion should be denied. Conley v. Gibson, 355 U.S. 41, 45-46, 78 S. Ct. 99, 102 (1957). "Because this standard imposes such a heavy burden on the defendant, Rule 12(b)(6) motions are rarely granted." Jones, 277 B.R. at 819 (internal citations omitted).

Because this adversary proceeding was converted from a pair of motions, there is no formal complaint. Therefore, the Court will consider the allegations set forth in the motions and other allegations made on the record in the context of the motion to dismiss to determine whether Debtor has stated a claim upon which relief can be granted.

The allegations made by Debtor are as follows: (1) Debtor and the Department of Labor entered into a settlement agreement for the repayment of certain unemployment insurance benefits received by Debtor; (2) on August 17, 2002, Defendants had Debtor incarcerated on a criminal

warrant based on the receipt of those benefits; (3) at that time, Defendants had notice that Debtor was in bankruptcy; (4) Defendants used the criminal process to frustrate the purpose of bankruptcy and the automatic stay; (5) Defendants initiated the criminal action with the intent to collect property of the bankruptcy estate; (6) Debtor has no bad faith defense to the criminal action based on a "debt collection" motive; and (7) Defendants tried to collect a debt in violation of the automatic stay.

The Court first turns its attention to the allegations that Defendants violated the automatic stay. Generally, the filing of a bankruptcy petition acts to stay, or enjoin, all court proceedings. 11 U.S.C.A. § 362(a)(1). However, the stay does not apply to "the commencement or continuation of a criminal action or proceeding against the debtor[.]" Id. § 362(b)(1). This language has been broadly interpreted to encompass all criminal proceedings, regardless of their purpose, i.e., criminal cases commenced solely to collect a debt are unaffected by the automatic stay. Gruntz v. County of Los Angeles, 202 F.3d 1074, 1087 (9th Cir. 2000); but see Sheppard v. Piggly Wiggly (In re Sheppard), No. 99-41085, 2000 WL 33743081, at *2 (Bankr. M.D. Ga. January 6, 2000) (finding that a criminal warrant for writing bad checks violated the automatic stay). Thus, even accepting all Debtor's allegations as true, he could prove no set of facts to support his allegation that the criminal action violates the automatic stay.

Although a criminal prosecution cannot be automatically stayed, it can be subject to a separate injunction imposed pursuant to the bankruptcy court's Section 105(a) power. This is confirmed by the legislative history to Section 362(b), which states that while criminal prosecutions "generally should not be stayed automatically upon the commencement of the case, for reasons of

either policy or practicality," the court may still "determine on a case-by-case basis whether a particular action which may be harming the estate should be stayed." H. Rept. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977), p. 342, reprinted in C Collier on Bankruptcy, App. Pt. 4(d)(i) (15th ed. rev'd 2003); see also Gruntz, 202 F.3d at 1087 ("The bankruptcy court's injunctive power [under § 105(a)] is not limited by the delineated exceptions to the automatic stay, nor confined to civil proceedings."). Under Section 105(a), "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. One purpose of the Code is to provide a debtor with breathing room from his creditors to enable him to reorganize his finances. Nevertheless, bankruptcy is not intended to be a haven for criminals. Barnette v. Evans, 653 F.2d 1250, 1251 (11th Cir. 1982).

The United States Supreme Court addressed the ability of federal courts to provide equitable relief from state criminal prosecution in Younger v. Harris, 401 U.S. 37, 91 S. Ct. 746 (1971), a nonbankruptcy case. In Younger, the Court recognized a long-standing policy of noninterference by federal courts into state court proceedings that is rooted in concepts of equity jurisprudence and comity. Id. at 43-44, 91 S. Ct. at 750. That policy has been embodied in the Anti-Injunction Act, which has survived virtually unchanged since its predecessor was enacted in 1793. Id. at 43, 91 S. Ct. at 750 (citing 28 U.S.C.A. § 2283 (West 1994)). Pursuant to that Act, a federal court may enjoin a state court proceeding only (1) when expressly authorized to do so by Congress; (2) when "'necessary in aid of its jurisdiction'"; or (3) "'to protect or effectuate its judgments.'" Id., 91 S. Ct. at 749 (quoting 28 U.S.C.A. § 2283). In addition, courts have recognized an exception when "a person about to be prosecuted in a state court can show that he

will, if the proceeding in the state court is not enjoined, suffer irreparable damages." Id. (citing Ex parte Young, 209 U.S. 123, 28 S. Ct. 441 (1908)).

The Eleventh Circuit Court of Appeals has construed Younger as creating a two-prong test for the injunction of a state criminal prosecution by a bankruptcy court: First, there must be a threat of great and immediate injury. Barnette, 673 F.2d at 1252. Second, the injunction must be "necessary to preserve a federally protected right." Id. In Barnette, the debtor was subject to a criminal prosecution for writing bad checks. Id. at 1251. The bankruptcy court enjoined the prosecution because it *might* result in a penalty of restitution for a debt that *might* be discharged, which would infringe upon the bankruptcy court's jurisdiction to discharge debts. Id. The court of appeals dissolved the injunction because the threat of injury had been merely hypothetical rather than immediate and because the debtor had no federal right to protection from the imposition of restitution. Id. at 1252.

While rejecting an injunction under the facts before it, the court in Barnette, noted that some courts enjoin state criminal proceedings when "subversion of the criminal process to collect debt was found." Id. That theory was not available in Barnette because the bankruptcy court had made "no finding of abuse of the criminal process." Id. The bankruptcy judge had been concerned with the *effect* of the criminal case–imposition of restitution for a debt that might be discharged–rather than the *purpose* of the case, which may have been debt collection. Id. But, even if the bankruptcy court had found abuse, the debtor had an opportunity to raise that abuse as a defense in the criminal proceeding. Id. (citing Tolbert v. State, 321 So.2d 227, 232 (Ala. 1975) (holding that use of bad check laws for debt collection purposes violates the Alabama

constitution)). Thus, the injunction would not be necessary to protect his rights under the Bankruptcy Code.

Three cases from the bankruptcy court in this district have considered enjoining state criminal proceedings. In Tenpins Bowling, Ltd. v. Alderman (In re Tenpins Bowling, Ltd.), 32 B.R. 474 (Bankr. M.D. Ga. 1983) (Hershner, J.), the debtor failed to pay its employees. Three days after the debtor filed Chapter 11, some of the employees swore out warrants against the debtor's principal for theft of services. The debtor's principal sought to enjoin prosecution of the existing warrants and to enjoin swearing out of future warrants. Id. at 476-77. The bankruptcy court declined to grant a permanent injunction. Id. at 482. According to the court in Tenpins, Barnette established a "bad faith" test for enjoining state criminal proceedings. Id. at 480. Although the court did not attempt to define "bad faith," it seemed to accept the proposition that using a criminal case as "a subterfuge for debt collection" can constitute bad faith. Id. at 481. In determining that the prosecutor had not acted in bad faith, the court noted that "[t]here was no showing that [the prosecutor] is using the criminal process solely as a means of debt collection." Id. In addition to bad faith, the debtor must show that he can't raise a "debt collection defense" in state court. Id. at 480.

In Jones v. Mann (In re Jones), 277 B.R. 816 (Bankr. M.D. Ga. 2001) (Walker, J.),[4] the creditor obtained a prepetition civil judgment against the debtor. After filing for bankruptcy, the debtor received a discharge of debts, including the judgment. The creditor subsequently swore out

[4] See also the nearly identical companion case Jones v. Mann (In re Jones), 279 B.R. 370 (Bankr. M.D. Ga. 2001).

a criminal warrant based on fraud, and the debtor was indicted. The debtor alleged that the criminal prosecution violated the discharge injunction. Thus, the debtor sought to enjoin the criminal proceeding. Id. at 817-18.

The court began by analyzing the "bad faith" prong of Barnette, but did so only in the context of whether the prosecutor had a reasonable expectation of obtaining a conviction. Id. at 820. The court found no bad faith because the debtor failed to show "the absence of fair state judicial proceedings." Id. The court did not address whether using the criminal courts solely as a debt collection mechanism would result in unfair proceedings. As to the other prong of Barnette, the court said the debtor must show an "inability to raise claims of bad faith in state proceedings." Id. at 821. The court found that the debtor failed to make any showing that it would not have the opportunity to raise bad faith as a defense in state court. Id. Rather, the court stated that, as a general rule, defendants can raise bad faith in state criminal proceedings. Id.

In Sheppard v. Piggly Wiggly (In re Sheppard), No. 99-41085, 2000 WL 33743081 (Bankr. M.D. Ga. Jan. 6, 2000) (Laney, J.), the court provided no analysis of the "bad faith" prong of Barnette, but briefly discussed the "defense" prong. The court noted that unlike Alabama, where Barnette arose, Georgia provides no "debt collection motive" defense to a criminal action. Id. at *1. The court determined this by examining the index to the Georgia Criminal Code provided by the debtor. Id. The creditor apparently raised no opposition to the debtor's allegations. Thus, the second prong of Barnette was satisfied. Id.

It is not easy to extrapolate a clear rule from the preceding cases. However, they are all in agreement that Barnette requires a two-prong analysis to determine whether the Court should

abstain from interfering with the state court criminal proceeding. First, to show a threat of great and immediate injury, the debtor must allege some bad faith in the criminal case. Second, to demonstrate the necessity of an injunction to protect a federal right, the debtor must show that he is unable to raise a defense in the state court based on his allegation of bad faith.[5] In order for Debtor in the present case to meet the low threshold required to state a claim upon which relief may be granted, he must have alleged facts that address both prongs of Barnette. Debtor in this case has done so by alleging improper use of the criminal system for purposes of collecting a debt in contravention of the Bankruptcy Code, and alleging that Georgia provides no defense based on that debt collection motive in the criminal case. As a result, the Court will deny Defendants' motion to dismiss. However, the Court notes that while Debtor may have breached the relatively low hurdle of stating a claim upon which relief can be granted, he still faces the considerably higher burden of proving his case on the merits.

An Order in accordance with this Opinion will be entered on this date.

Dated this 12th day of June, 2003.

James D. Walker, Jr.
United States Bankruptcy Judge

[5] There may be other ways to satisfy the Barnette test. However, due to the circumstances of this case, the Court need consider Barnette in a broader context.

CERTIFICATE OF SERVICE

I, Cheryl L. Spilman, certify that the attached and foregoing have been served on the following:

Cawthon H. Custer
Post Office Box 605
Albany, Georgia 31702-0605

W. Wright Banks, Jr.
40 Capitol Square, SW
Atlanta, Georgia 30334-1300

Kristin Smith
Post Office Box 1907
Columbus, Georgia 31902

This 12th day of June, 2003.

_____

Cheryl L. Spilman
Deputy Clerk
United States Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
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VS.	)	
	)	
TOMMY GOODE and GEORGIA DEPARTMENT OF LABOR,	)	
	)	
DEFENDANTS.	)	

ORDER

In accordance with the Memorandum Opinion entered on this date, the Court hereby DENIES Defendants Georgia Department of Labor and Tommy Goode's Motion to Dismiss.

So ORDERED, this 12th day of June, 2003.

_____
James D. Walker, Jr.
United States Bankruptcy Judge

CERTIFICATE OF SERVICE

I, Cheryl L. Spilman, certify that the attached and foregoing have been served on the following:

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