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DOMINO EFFECT: THE CONTINUED EXISTENCE OF LIABILITY FOR FRAUD IN BANKRUPTCY DESPITE GOOD-FAITH SETTLEMENT BY THE HONESTLY UNFORTUNATE SETTLOR

Theresa J. Pulley Radwan

“It is not true that men can be divided into absolutely honest persons and absolutely dishonest ones. Our honesty varies with the strain put on it.”

–George Bernard Shaw

I. INTRODUCTION

Imagine three debtors, Adam, Brian, and Chris, each of whom finds himself deeply in debt. For each, a significant portion of his debt involves money due under a settlement agreement between the debtor and a purchaser of the debtor’s business. Shortly after buying the business, the purchaser alleged that the debtor made fraudulent misrepresentations regarding the client base of the business. Adam, Brian, and Chris each proclaim the accuracy of his statements regarding the business, claiming that the buyer misinterpreted those statements. Although each intended to prove that assertion in court, when discovery began, each debtor realized the time-consuming, expensive, and unpredictable nature of litigation. Each chose settlement as the wisest approach and agreed to pay the buyer $100,000, payable in twenty monthly installments of $5,000 each.

When Adam entered into the agreement, he knew that he could never make those payments, but nevertheless represented to the buyer that he would pay those obligations in full and on time. The agreement contained a provision expressly releasing Adam from any further claims regarding the sale of the business. After paying $50,000, Adam filed for Chapter 7 bankruptcy protection.

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Brian’s agreement, like Adam’s settlement, contained a provision waiving all of the buyer’s claims against Brian under the original purchase agreement. However, unlike Adam, Brian entered into the agreement believing that he could, indeed, make those payments. But, after making ten payments, the poor economy took its toll on Brian. He lost his job and saw his savings and retirement accounts dwindle away in the stock market. Brian also filed for Chapter 7 bankruptcy protection.

Finally, Chris signed the agreement fully expecting to make all payments due thereunder. Unfortunately, Chris also lost his job, his savings, and his retirement funds due to the poor economy, and after making $50,000 in payments on the settlement agreement, he filed for bankruptcy protection. The agreement between Chris and his buyer provided that the buyer could re-allege its fraud claims if Chris defaulted on his obligations under the agreement.

For each of these three debtors, bankruptcy provides the hope of starting over. Though bankruptcies present new challenges for debtors, who must now face a world of reduced credit, they also provide an opportunity for debtors to obtain a fresh start through the discharge of debts not paid in the bankruptcy proceeding. But for each of them, a recent decision of the United States Supreme Court, Archer v. Warner, which provides that the amounts due under the settlement agreements will continue post-bankruptcy if the creditor can prove the existence of fraud, regardless of the circumstances surrounding the settlement, limits the debtor’s ability to receive a fresh start. In rendering its decision, the Court decided a question debated by the bankruptcy courts for nearly half a century. The Court provided additional protections for creditors to the detriment of debtors, such as Brian and Chris, who, in good faith, tried to right their prior wrongs. This decision undermines the policies and practicalities of settlements simply to prevent a debtor like Adam,

2. See 11 U.S.C. § 524(a) (2000). A discharge renders prepetition judgments against the debtor ineffective and prevents any creditor from seeking to collect against the debtor on a prepetition claim. Id. Thus, the discharge allows the debtor to escape the confines of indebtedness after making the required payments to creditors in the bankruptcy proceeding. See id.


4. Id. The Court, however, cannot determine the dischargeability of such debts unless the creditor owed the debt files a complaint alleging nondischargeability of the claim. FED. R. BANKR. P. 4007(a). That claim then instigates an adversary proceeding, in which the court decides whether to discharge the amount due to the creditor. FED. R. BANKR. P. 7001(6).


6. Archer, 538 U.S. at 323.
who enters into the settlement agreement specifically to discharge it in bankruptcy, from receiving such a discharge. Although *Archer* effectively prevents debtors like Adam from receiving a discharge, the Bankruptcy Code can prevent such creditors from receiving a discharge without unduly burdening debtors that are honestly trying to resolve prior disputes.  

II. THE BASICS OF DISCHARGEABILITY

Persons or entities file for protection under the Bankruptcy Code for a wide variety of reasons. Whatever the reason, the Bankruptcy Code serves at least one major role in the debtor's life—to provide an orderly means for repaying creditors. Rarely, if ever, can a debtor pay every creditor the full amount owed. This situation then presents the problem of what happens to the remaining unpaid debt. If a business liquidates through a Chapter 7 proceeding, the business no longer exists. Clearly, then, the creditor can receive nothing more from the debtor than the amount already paid. However, when the debtor continues to exist post-bankruptcy, as either a living individual or a business that

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7. *Id.*

8. *See infra* note 276 (recognizing the ability to hold fraudulently-incurred settlement debt nondischargeable).


12. 1 NORTON BANKR. L. & PRAC. 2d § 18:8 n.1.

13. This does not mean, of course, that the creditor will receive nothing more on its claim. The creditor may instead look to a surety, co-signor, partner, insurer, or other responsible entity for payment of the remainder due. *See* 11 U.S.C. § 524(e) (2000) (explaining that the "discharge of a debt of the debtor does not affect the liability of any other entity").
reorganizes rather than liquidates, the means for repayment of the debt continue. To hold the debtor liable for the remainder of the debt not paid through the bankruptcy proceeding presents a difficult problem because it places the debtor in exactly the same position as prior to the bankruptcy filing. Time becomes the only benefit enjoyed by the debtor as a result of filing for bankruptcy protection; the debtor manages to enjoy time to pay off some debt without the pressures of lawsuits and harassment by creditors. Particularly in the context of a Chapter 7 action, which typically lasts less than a year, the relatively short time period may not allow the debtor to find means to repay the remaining debt, and the debtor will find himself back where he began. To give the debtor more concrete benefits in bankruptcy, the Bankruptcy Code provides that a debtor who completes bankruptcy receives a discharge of his debts not actually paid in the bankruptcy proceeding. This discharge allows a debtor to receive a "fresh start" after the conclusion of the bankruptcy—the opportunity to begin again.

For obvious reasons, the fresh start is a concern to creditors who may receive little, or none, of the amount due to them once the debtor files for bankruptcy protection. To protect some of these creditors, Congress enacted exceptions to the general rule of discharge of debts. At present, nineteen specific exceptions exist to discharge of indebtedness,


16. 11 U.S.C. §§ 727(b), 1141(c), 1228(a), 1328(a) (2000).

17. See FCC v. NextWave Pers. Communications, Inc., 527 U.S. 293 (2003) (asserting that the purpose of the Bankruptcy Code is to provide a "fresh start"); Grogan v. Garner, 498 U.S. 279, 286-87 (1991) (discussing the Bankruptcy Code's "fresh start policy"); Boston Univ. v. Mehta (In re Mehta), 310 F.3d 308, 311 (3d Cir. 2002) (explaining the delicate balance between a debtor's right to a fresh start and a creditor's need for protection). See also WILLIAM L. NORTON, JR., 3 NORTON BANKR. L. & PRAC. 2d § 48:1 ("In fact, in most consumer Chapter 7 cases the prospect of the discharge of existing liabilities is the major, if not the only, goal of the debtor."); Radwan, supra note 10, at 993 n.20 (noting wide acceptance of fresh start policy within bankruptcy).


19. Id.
along with a number of grounds for denying discharge of all of the debtor's unpaid debts.\(^{20}\) Fraud provides but one of the reasons to exempt a debt from discharge.\(^ {21}\) Courts generally discharge contract debts unless they fall within one of the grounds for nondischargeability.\(^ {22}\) Thus, simply alleging that a contract debt exists will not prevent its discharge.\(^ {23}\)

**A. The Archer v. Warner Decision**

*Archer v. Warner*\(^ {24}\) stemmed from garden-variety, fraud-settlement dischargeability facts.\(^ {25}\) This issue arose when parties to a lawsuit alleging fraud settled the claim without a judgment on the fraud and with no mention in the settlement agreement of what should happen to the fraud claim in the event of bankruptcy.\(^ {26}\) Specifically, the Warners sold their business, Warner Manufacturing, Inc., to the Archers.\(^ {27}\) After the sale, the Archers claimed that the Warners fraudulently induced them to purchase the business.\(^ {28}\) The parties settled the fraud claims in 1995 for

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\(^{20}\) *Id.* § 727(a). See also *id.* § 727(d) (allowing revocation of a discharge wrongfully obtained); *id.* § 1141(d)(3)(C) (extending the general denial of discharge into Chapter 11); *id.* § 1328(d) (denying discharge in Chapter 13 for debtors who fail to make minimum payments).

\(^{21}\) *Id.* §§ 523(a)(2), (4).

\(^{22}\) See *id.* § 727(a) (stating that the court must grant the debtor a discharge unless one of the exceptions in the Bankruptcy Code applies); see also Norton, Jr., supra note 17, § 47.59 (“Debt associated with a prepetition contract is discharged . . . absent a statutory exception.”).


\(^{25}\) See *id.* at 316-17. The Court outlined the circumstances of the case:

1. A sues B seeking money that (A says) B obtained through fraud;
2. the parties settle the lawsuit and release related claims;
3. the settlement agreement does not resolve the issue of fraud, but provides that B will pay A a fixed sum;
4. B does not pay the fixed sum;
5. B enters bankruptcy; and
6. A claims that B’s obligation to pay the fixed settlement sum is nondischargeable because, like the original debt, it is for “money . . . obtained by . . . fraud.”

*Id.*

\(^{26}\) See *id.* at 317. Typically, a settlement agreement cannot serve as an admission of liability absent an express indication of such liability. See, e.g., Fed. R. Evid. 408 (prohibiting use of settlement negotiations to prove liability in federal courts); Signature Dev. Cos., Inc. v. Royal Ins. Co. of Am., 230 F.3d 1215, 1223 (10th Cir. 2000) (prohibiting use of settlement negotiations to prove liability under Colorado law) (citing Martin v. Principal Cas. Ins. Co., 835 P.2d 505 (Colo. Ct. App. 1991), rev’d on other grounds, 855 P.2d 1377 (Colo. 1993)). Thus, because the creditor failed to establish fraud in the underlying state court proceeding and the settlement agreement did not contain an admission of fraud, the creditor must then prove fraud in the bankruptcy court in order to establish nondischargeability. See Archer, 538 U.S. at 317-18.

\(^{27}\) Archer, 538 U.S. at 317.

$300,000; the Warners paid $200,000 immediately and signed a
promissory note to repay the remaining $100,000 within the next year.29
The settlement agreement provided that the Archers released the
Warners from liability on the alleged fraud upon signing the agreement.30
Before making a single payment on the $100,000 due under the
promissory note, the Warners filed for bankruptcy protection.31

In the bankruptcy proceeding, the Archers and the Warners agreed
that the amount due to the Archers totaled $100,000.32 Leonard
accepted that he could not discharge the amount due to the Archers after
bankruptcy.33 Arlene, however, contended that she could discharge the
remainder due under the settlement agreement in bankruptcy because it
represented amounts due pursuant to a contract.34 The Archers
disagreed, arguing that even a contractual debt constitutes
nondischargeable fraud debt if the contract arose out of a fraud claim.35
Although the Archers tried to amend their complaint in the bankruptcy
proceeding to include an allegation that the Warners fraudulently
induced them to enter into the settlement agreement,36 the court
considered only the effect of the original fraud alleged in the sale of the
business.37

29. Brief for the United States at *2, Archer (No. 01-1418). Unlike many cases, a lien
secured the $100,000 promissory note. In re Warner, 283 F.3d at 233-35. The court
neglected to reveal the nature or value of the collateral securing the loan, though it
indicated that the collateral included real estate. Id. at 235.
30. Archer, 538 U.S. 317. See also Bankruptcy--Dischargeable Debts: Settlement of
Fraud Claims Creates Contract Debt Dischargeable in Bankruptcy, 70 U.S. L. WK. 1545,
1547 (Mar. 19, 2002) (discussing Archer: “Accompanying releases stated that the
purchasers ‘release and forever discharge the . . . [Warners] from the beginning of the
world to the date of the release’ for all liabilities arising from the state action.”).
31. Archer, 538 U.S. 317. Actually, the Warners failed to pay the first installment due
under the settlement agreement, and the Archers responded by filing a lawsuit based in
breach of contract, which prompted the Warners to file for bankruptcy. Id.
32. Id. at 317.
33. Id. at 318.
34. See id.
35. Id.
37. Id.
The bankruptcy court, the district court, and the court of appeals all agreed with Arlene Warner, finding that a contractual settlement that releases the defendant from liability on the underlying fraud claim turns the nondischargeable fraud debt into a dischargeable contract claim. The decision followed the reasoning of the Seventh and Ninth Circuits in similar cases. Additionally, the Fourth Circuit voiced concern that to refuse discharge of such a debt would discourage a debtor from entering into a settlement agreement because the debtor would know that he could litigate the issue anyway if a bankruptcy ensues.

In his dissent, Judge Traxler noted the Supreme Court's long history of dealing with fraud dischargeability issues. Judge Traxler argued that precedent requires a denial of discharge for any debt linked to fraud:

Thus, the message delivered by a unanimous Supreme Court on three separate occasions has been clear. In deciding cases dealing with the fraud exceptions to dischargeability, courts should effectuate congressional policy objectives by conducting the fullest possible inquiry into the nature of the debt and limiting relief to the honest but unfortunate debtor.

The Archers filed a petition for certiorari with the United States Supreme Court, which the Court granted on June 24, 2002. The Court heard the case on January 13, 2003 and rendered its decision in favor of the Archers on March 31, 2003.

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38. _Id._ at 232.
39. _Id._ at 236.
40. _In re West_, 22 F.3d 775, 778 (7th Cir. 1994).
41. Key Bar Invs., Inc. _v._ Fischer (_In re Fischer_), 116 F.3d 388, 390 (9th Cir. 1997), amended by 127 F.3d 819 (9th Cir. 1997) (explaining that the agreement had created a novation, which diminished all claims).
42. _In re Warner_, 283 F.3d at 236. Although the courts call this a novation, the Fourth Circuit recognized that the term “novation” typically involves a substitution of the parties to contract, rather than the substitution of a contract claim for a tort claim. _Id._ at 236 n.8 (citing BLACK'S LAW DICTIONARY 1091 (7th ed. 1999)). _See also_, Prod. Credit Ass'n _v._ Alamo Ranch Co., 989 F.2d 413, 418 (10th Cir. 1993) (defining elements of novation to include “1) an existing and valid contract; 2) an agreement to the new contract by all the parties; 3) a new valid contract; and 4) an extinguishment of the old contract by the new one”).
43. _In re Warner_, 283 F.3d at 236.
44. _Id._ at 238-39 (J. Traxler, dissenting).
45. _Id._ at 239 (J. Traxler, dissenting).
Concern over the potential effects of the Fourth Circuit's decision flow throughout the amicus curiae briefs filed in support of the Archers.\textsuperscript{49} For example, the American Association of Retired Persons (AARP) noted that "[a]dopting respondent's position in this case not only would expose older Americans and other victims of fraud to greater risk of nonrecovery, but would also have the adverse policy effect of encouraging these victims to litigate their fraud cases to judgment, rather than accepted negotiated resolutions."\textsuperscript{50} The United States also filed an amicus brief, stating that "[t]he only settlements encouraged by the court of appeals' decision are those induced by a desire to ensure that the settlement debt may be discharged in bankruptcy, even where the debtor actually committed fraud."\textsuperscript{51} Clearly, these organizations shared the same concern expressed by Judge Traxler in his dissent—the concern that innocent creditors will suffer at the hands of defrauding debtors.\textsuperscript{52}

A divided Supreme Court reversed the Fourth Circuit finding of settlement debt as dischargeable.\textsuperscript{53} Although the majority discussed principles of \textit{res judicata} and collateral estoppel extensively, the Court ultimately left the lower courts to decide whether to apply these concepts, noting that different states interpret the preclusive effect of a settlement agreement differently.\textsuperscript{54} The majority focused on the prior decisions noted by Judge Traxler in his dissent,\textsuperscript{55} finding that a knowledgeable debtor's mere change in the form of a debt would not render such debt dischargeable.\textsuperscript{56} In so determining, the Court focused on prior decisions granting discharge only to ""honest, but unfortunate

\begin{itemize}
  \item \textsuperscript{49} See generally Brief for the United States, Archer (No. 01-1418); Brief for AARP as Amicus Curiae in Support of Petitioners [hereinafter Brief for AARP], Archer v. Warner, 538 U.S. 314 (2003) (No. 01-1418), available at http://supreme.lp.findlaw.com/supreme_court/briefs/01-1418/01-1418.mer.ami.aarp.pdf.
  \item \textsuperscript{50} Brief for AARP at 6, Archer (No. 01-1418).
  \item \textsuperscript{51} Brief for the United States at *8, Archer (No. 01-1418).
  \item \textsuperscript{52} See Archer v. Warner (\textit{In re} Warner), 283 F.3d 230, 239-40 (Traxler, J., dissenting).
  \item \textsuperscript{53} Archer, 538 U.S. at 315, 323. Justice Thomas was joined in dissent by Justice Stevens. Id. at 323.
  \item \textsuperscript{55} See \textit{In re Warner}, 283 F.3d at 237.
  \item \textsuperscript{56} Archer, 538 U.S. at 320-22 (citing Brown v. Felsen, 442 U.S. 127, 138 (1979)); \textit{In re Warner}, 283 F.3d at 237 (J. Traxler, dissenting).\end{itemize}
debtor[s].'" Even though the fraud did not arise in preparation of the settlement contract, the Court decided that a debtor who commits fraud can never erase the dishonesty of that original fraud. Thus, even a good-faith settlement resolving the fraud issue would not suffice, because the fraud brands the subsequent debt.

In making its decision, the Court also examined the evolution of the language of section 523(a)(2)(A) of the Bankruptcy Code. Section 523(a)(2)(A) mirrors section 17a of the 1898 Bankruptcy Act. Originally, the fraud discharge exception required a judgment of fraud liability in order to find nondischargeability. The Court reasoned that the elimination of the judgment requirement in favor of a "liability" requirement indicated that settlements of fraud allegations, as debts "'arising out of' fraud," fell into the exception to discharge, provided that the creditor could actually prove fraud. The Archer Court, however, merely created the possibility for a denial of discharge, remanding the case for a determination on the underlying fraud allegations.

In a vigorous dissent, Justice Thomas considered the paradox of using the underlying fraud to determine dischargeability, while using the settlement agreement to determine the amount of liability for that nondischargeable fraud. It provides an inconsistent result to prohibit discharge of a fraud debt in order to punish dishonest debtors, while only providing the defrauded creditor the settled-upon amount.

The Supreme Court's reliance on a statement in Brown v. Felsen demonstrates its underlying fear of dishonest debtors: "the mere fact that a conscientious creditor has previously reduced his claim to judgment

58. Archer, 538 U.S. at 322-23.
59. See id. The Court did not determine the enforceability of an express statement rendering the settlement debt dischargeable in the event of bankruptcy. But see Warner, supra note 28 (stating that Supreme Court's decision would invalidate such a provision).
64. Id. at 322. The Archer Court merely created the possibility of a denial of discharge, remanding the case for a determination on the underlying fraud allegations. Id.
65. Id. at 325-27 (Thomas, J., dissenting).
66. See id.
should not bar further inquiry into the true nature of the debt." The Court fears that a debtor might fraudulently incur debt, enter into a settlement agreement solely to convert that debt into dischargeable contract debt, and indeed follow through with a bankruptcy filing seeking a discharge of the settlement debt.

B. The Circuit Court Split

The vast majority of bankruptcy and district court cases considering the issue of discharge of settled fraud claims, prior to Archer, held settlement debt nondischargeable in bankruptcy, so long as the creditor could prove that fraud actually occurred. However, the Circuit Courts

68. Archer, 538 U.S. at 320-21 (citing Brown, 442 U.S. at 138).

69. The same fear evidences itself in various cases predating Archer, as well as in the opinions of legal scholars:

Prior to the bankruptcy, the debtor reduced the controversy over its alleged misfeasance to a stipulated amount . . . . [O]ne would think that such a dishonest debtor would not be able to hide behind the shield of bankruptcy, let alone wield it as a sword . . . . But this is not always happening. In a startling turn of events, certain high appellate courts are condoning the unscrupulous actions of wrongdoers, and permitting them to exercise the normal prerogatives of bankruptcy to erase debts obtained by fraud, merely by the happenstance that the underlying controversies were reduced to settled amounts.

. . . Fulfilling this tribunal’s mandate only serves to allow, in fact encourage, miscreant debtors to settle, and then promptly file for bankruptcy, secure in the knowledge they have succeeded in transmogrifying an originally nondischargeable debt into a standard contract claim capable of eradication.

Anthony Michael Sabino, Preventing an Alchemy of Evil: Preserving the Nondischargeability of a Debt Obtained by Fraud, 12 J. BANKR. L. & PRAC. 99, 100, 144 (2003); see also United States v. Spicer, 57 F.3d 1152, 1156 (D.C. Cir. 1995) ("Settlement makes the dishonest debtor no more honest, and no more entitled to the relief Congress intended to reserve for the honest debtor."); Greenberg v. Schs., 711 F.2d 152, 154 (11th Cir. 1983) ("Appellee[’s interpretation] would allow a debtor to discharge a debt incurred by his own fraud by simply entering into a settlement agreement . . . . The debtor could even accept a substantially adverse settlement [knowing] that its terms . . . would be nullified by the subsequent petition in bankruptcy."); Haynes v. Bobofchak (In re Bobofchak), 101 B.R. 465, 468 (Bankr. E.D. Va. 1989) ("The intent of Congress to except from discharge debts incurred by means of fraud or defalcation could effectively be short-circuited by a simple execution of settlement."); Kleinberg, supra note 5, at 390 ("[T]here would seem to be no reason the mere fact that a conscientious creditor has previously reduced its claim to settlement should bar . . . an inquiry [into fraud]."); David Zelikoff, Fraud by Any Other Name Is Still Fraud: Settling a Potential Fraud Claim Under the Bankruptcy Code, 64 GEO. WASH. L. REV. 866, 874 (1996) ("The fraudulent debtor cannot escape liability by using the Bankruptcy Code to his advantage. . . .").

of Appeal divided more evenly. The Second,\textsuperscript{71} Eleventh,\textsuperscript{72} and D.C.\textsuperscript{73} Circuits, as well as the Sixth Circuit's Bankruptcy Appellate Panel,\textsuperscript{74} agreed that debtors could not discharge settled fraud claims, while the Fourth,\textsuperscript{75} Seventh,\textsuperscript{76} and Ninth\textsuperscript{77} Circuits allowed such a discharge, despite proof of the underlying fraud.\textsuperscript{78}

1. Cases Prohibiting Discharge

With its decision in \textit{Greenberg v. Schools},\textsuperscript{79} the Eleventh Circuit became the first circuit court to hold that a debtor could not automatically discharge amounts due under a settlement agreement in bankruptcy.\textsuperscript{80} Basing its analysis on a 1939 embezzlement case, the court held that a settlement cannot change the character of an underlying debt.\textsuperscript{81} Although the court found legal support for its conclusion, it focused primarily on policy concerns:

\begin{itemize}
  \item 71. \textit{Giaimo}, 326 F.3d at 320.
  \item 72. Fuller v. Johanness (\textit{In re Johanness}), 76 F.3d 347, 350 (11th Cir. 1996); \textit{Greenberg}, 711 F.2d at 156.
  \item 73. \textit{Spicer}, 57 F.3d at 1161.
  \item 76. \textit{In re West}, 22 F.3d 775, 778 (7th Cir. 1994).
  \item 77. Key Bar Invs., Inc. v. Fischer, 116 F.3d 388, 390-91 (9th Cir. 1997).
  \item 78. The Tenth Circuit came close to rendering a decision on the issue in \textit{Arnold v. Employers Ins. of Wausau}, in which the court held that a promissory note evidencing a fraud debt did not substitute a contract claim for a tort claim, and denied discharge. 465 F.2d 354 (10th Cir. 1972). The issue in \textit{Arnold} differs from that of \textit{Archer} in two significant ways. \textit{Id.} at 356. First, the debtor in \textit{Arnold} admitted to the fraud. \textit{Id.} Second, the note did not settle the fraud liability; rather, it simply documented the debtor's willingness to voluntarily repay his fraud debt. \textit{Id.} Such a situation truly would elevate "form over substance" and defeat Congress’s intent in enacting § 523. See Rodriguez v. Valencia (\textit{In re Valencia}), 280 B.R. 520, 521-22 (Bankr. D. Colo. 2002) (noting the lack of a Tenth Circuit decision with regard to settlement agreements, but stating that such a discharge would "elevate form over substance"). Although it has not decided the issue, the Third Circuit has held that, generally, the Bankruptcy Code cannot turn a settlement agreement from a contract into something noncontractual:
    Generally, application of the Bankruptcy Code does not change the attributes of a given legal relationship. Thus, if the settlement agreement should be considered a contract under relevant nonbankruptcy law, it will be a contract in bankruptcy "[u]nless some federal interest requires a different result" . . . . Although settlement agreements may be judicially approved, they share many characteristics of voluntary contracts . . . .


80. \textit{Id.} at 156.

81. \textit{Id.} at 155-56.
The interpretation urged by the appellee would allow a debtor to discharge a debt incurred by his own fraud by simply entering into a settlement agreement prior to declaring bankruptcy. The debtor could even accept a substantially adverse settlement with the knowledge that its terms and conditions would be nullified by the subsequent petition in bankruptcy.

The court then determined that the debt "unquestionably [arose as] the result of the debtor's fraud," and refused discharge. Thus, the existence of fraud tainted all indebtedness resulting from that fraud. Like its finding in Archer, the Greenberg Court found that, although the debt resulted from fraud, the nondischargeable claim could not exceed the settled-upon amount of damages. Interestingly, the court failed to mention the existence of a release within the settlement agreement. However, the court's ultimate decision that fraud continued despite the existence of a settlement agreement implicitly rendered the existence of such a release irrelevant.

Agreeing with the Eleventh Circuit, the Court of Appeals for the District of Columbia, in United States v. Spicer, held that a debtor cannot discharge a settlement agreement of a fraud claim once the creditor proves the underlying fraud. The settlement contract at issue in Spicer contained an express waiver of the underlying fraud claim. The Spicer case arose out of the debtor's admittedly false statements made to the Department of Housing and Urban Development (HUD). Noting that most other courts followed the Greenberg decision, the court held that "a fraudulent debtor remains a fraudulent debtor, and debt originating in fraud remains nondischargeable even if its legal form changes under a settlement agreement." The court rejected cases allowing discharge without a determination of fraud because such cases "elevat[e] legal form over substance." Because the debtor admitted the

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82. Id. at 154.
83. Id. at 156.
84. See id.
85. Id. at 153 (noting that the claim arises out of the settlement agreement).
86. See id. at 152.
87. 57 F.3d 1152 (D.C. Cir. 1995).
88. Id. at 1154.
89. Id.
90. Id.
91. Id. at 1155.
92. Id. at 1157.
93. Id. at 1155. The concern of form versus substance applies both in the context of granting a discharge and of denying a discharge. NORTON, supra note 17, at § 48:1 ("A liberal construction of the statutory requirements for discharge means that discharge should be denied only for real and substantial reasons, not on technical grounds.").
falsity of the statements made to HUD, the court held that fraud did indeed exist, and therefore refused to discharge the resulting settlement agreement.  

In *Giaimo v. Detrano*, a decision rendered just weeks after the Supreme Court's decision in *Archer*, the Second Circuit agreed that a debtor could not receive discharge of a settlement of a fraud claim simply because the claim now existed as a contract. Unlike *Greenberg* and *Spicer*, *Giaimo* involved embezzlement claims. Like the *Spicer* case, however, the settlement agreement included an express release of the debtor on the alleged embezzlement. The Second Circuit began with a discussion of *res judicata* principles, but found that, without a judgment on the embezzlement claim, *res judicata* could not apply. The court then turned its attention to the argument that the contractual settlement was a substitute for the original tort claim. In finding that the bankruptcy court must consider whether the embezzlement actually occurred, the court of appeals decided that "reducing a fraud claim to settlement [does] not change the nature of the debt for dischargeability purposes."

The *Greenberg*, *Spicer*, and *Giaimo* cases express one clear concern that is shared by the Supreme Court. The judges worry that debtors will use the contractual nature of a settlement agreement to escape obligations for fraudulent behavior at the expense of innocent creditors. Each court determines, in its own way, that the substance of the original fraud claim remains alive forever, regardless of the efforts or intent of the parties to change the fraud debt into a different type of claim.

In *Ed Schory & Sons, Inc. v. Francis*, the Sixth Circuit's Bankruptcy Appellate Panel outlined additional reasons for denying discharge of fraud settlement claims when creditors demonstrate fraud. Although the *Francis* case involved the question of whether to discharge a

94. *Spicer*, 57 F.3d at 1154, 1161.
96. *Id.* at 320-21.
97. *Id.*
98. *Id.* at 321.
99. *Id.* at 322.
100. *Id.* at 322-23.
101. *Id.* at 322.
103. *See supra* notes 79-102 and accompanying text.
105. *Id.* at 390-91.
settlement agreement based in fraud, the debtor in Francis actually admitted to the alleged fraud. Thus, the court only needed to determine whether the settlement agreement served to substitute a contract claim for the fraud claim. If the court answered that inquiry in the affirmative, then the debtor received a discharge. If the court answered in the negative, however, the debtor lost the possibility of discharge because the fraud clearly existed.

Refusing discharge of the settlement agreement, the Bankruptcy Appellate Panel first looked to cases finding the opposite result. Specifically, the court noted that Maryland Casualty Co. v. Cushing, upon which many other cases relied, only allowed a settlement agreement to replace a tort claim to the extent intended by the parties. The court argued that cases following Maryland Casualty misconstrued its holding to allow settlement agreements to replace nondischargeable tort claims under any circumstances. However, rather than returning to Maryland Casualty's intent-of-the-parties standard, the Francis court landed at the other extreme. The court failed to consider the intent of the parties, instead considering only the underlying cause of action settled by the contract, and the ability to prove the elements of that cause of action.

Second, the Panel noted that the Bankruptcy Code allows a debtor to waive his right to discharge only after the bankruptcy begins, and caselaw prohibits the debtor from waiving the right to file for bankruptcy protection. Although the court failed to explain the connection between these two concepts and denying discharge on a settlement claim

106. Id. at 387.
107. Id.
108. Id. at 384-90 (quoting Md. Casualty Co. v. Cushing, 171 F.2d 257, 258-59 (7th Cir. 1948)). The court reiterated, "if it is shown that the note . . . is given . . . as payment . . . of the tort action . . . [the debt] is fully satisfied." Id.; See also Elizabeth Warren & Jay L. Westbrook, Settling into Bankruptcy, 22 AM. BANKR. INST. J. 16 (2003) (discussing novation as substitution of a contract claim for a tort claim and the resulting ability to discharge).
109. Francis, 226 B.R. at 385-86 (noting the finding of the Bankruptcy Court that "due to several prior court decisions, collateral estoppel barred Francis from relitigating . . . fraud," and finding no novation and no discharge).
110. Id. at 392-93.
111. Id. at 389-90.
112. 171 F.2d 257 (7th Cir. 1948).
114. Id. at 390.
115. Id. at 389-92.
117. Id. (referring to Giaimo v. Detrano (In re Detrano), 222 B.R. 682, 685, 687 (Bankr. E.D.N.Y. 1998)).
based in fraud, presumably, the court believed that the concepts implied a Code policy disfavoring pre-bankruptcy changes to the form of a claim. Essentially, given that a debtor cannot waive discharge, to allow the debtor to use a contract settlement to create a right to discharge would lead to an injustice.

Third, the *Francis* court correctly indicates that courts prefer settlement agreements to litigation and that discharge of a settlement claim might discourage a creditor from settling a fraud claim. This notion becomes particularly important when entering into a settlement agreement with a debtor on the brink of financial ruin. A creditor, aware of the precarious financial position of the debtor, may find the risk of bankruptcy and subsequent discharge too great, and decide against settlement.

Finally, the *Francis* court found that the language of section 523(a)(2)(A) "plainly" indicates that a settlement agreement does not terminate the fraud underlying the settlement and that, discharge must be denied once the creditor proves fraud. The *Francis* court's logic mirrored that of the Supreme Court, finding that the statute's language prohibiting discharge of a debt, "to the extent" that a debtor fraudulently obtains money, indicated Congress's desire to continue the liability of a dishonest debtor.

Judge Lundin dissented from the *Francis* ruling, relying upon an Ohio law providing that courts must uphold a release contained within a settlement agreement absent clear and convincing evidence that the parties mistakenly entered into the settlement. Because the creditor failed to provide such evidence, Judge Lundin argued, the court must enforce the release terminating the fraud liability. In addition, Judge Lundin noted that Congress limited a debtor's ability to substitute dischargeable debt for nondischargeable debt in a related situation.

118. *Id.* at 390; *see also* 15A AM. JUR. 2D Compromise and Settlement § 5 (2000) ("Public policy favors the resolution of controversies and uncertainties through compromise and settlement rather than through litigation, and it is the policy of the law to uphold and enforce such contracts if they are fairly made and are not in contravention of some law or public policy. Settlement agreements are encouraged by courts.").

119. *Francis*, 226 B.R. at 390; *see also* Zelikoff, supra note 69, at 874 (arguing that the *Spicer* decision allows creditors to settle claims without regard to dischargeability and, thus, encourages creditors to settle claims).

120. *Francis*, 226 B.R. at 390.

121. *Id.*

122. *Id.* at 391.

123. *Id.*

124. *Id.* at 394 (Lundin, J., dissenting).

125. *Id.* at 394-95.

126. *Id.* at 396.
Section 523(a)(14) of the Bankruptcy Code denies discharge of debt incurred to pay a nondischargeable tax debt. 127 If Congress wished to create such a rule prohibiting the exchange of a dischargeable debt for nondischargeable fraud debt, it certainly could do so, but the creation of such a rule is not within the judiciary’s power. 128


(A) is a claim for—

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934, any state securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, in relation to any claim described in subparagraph (A), from—

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost or other payment owed by the debtor.

Id. (emphasis added). See G. Ray Warner, Accounting Reform Law Adds Broad Securities Fraud Discharge Exception, 21 AM. BANKR. INST. J. 6, 43 (2002) (arguing that the Act makes significant additions to § 523(a) by including violations of state and federal securities laws to the class of nondischargeable debts, regardless of fraudulent intent). Both sides of the fraud-settlement dischargeability debate will benefit from the addition of this subsection. Id. For favoring discharge of settlement debt, the Corporate Fraud Accountability Act indicates that Congress included an express statement of settlement agreement nondischargeability because nondischargeability of debt incurred by a violation of federal securities law or fraud involving a securities law did not automatically extend to settlement agreements. Id. Under Archer’s reasoning, the statute (which preceded Archer, but was not cited therein) would not need to extend nondischargeability to settlement agreements, at least those arising out of “common law fraud, deceit or manipulation” because the denial of discharge for securities fraud debt would cover such settlement agreements. Id. For the other side of the debate, the statute strengthens Congressional resolve to punish dishonest debtors, regardless of the form of indebtedness. Sabino, supra note 69, at 148. Rather than creating a new rule, the new statute merely clarifies Congressional intent regarding settlement agreements. See id.

128. Francis, 226 B.R. at 396 (Lundin, J., dissenting). Although the tax statute lends some credibility to Judge Lundin’s argument, one problem remains: The tax nondischargeability statute, which refuses discharge for “any debt . . . for a tax or a customs duty,” differs significantly from the fraud nondischargeability statute, which prohibits discharge for “any debt . . . for money . . . to the extent obtained by . . . fraud.” Compare 11 U.S.C. § 523(a)(1) (2000) (tax nondischargeability statute), with 11 U.S.C. § 523(a)(2)(A) (2000) (fraud nondischargeability statute). Given the Cohen Court’s focus on the “to the extent obtained by” language of § 523(a)(2) as indicating that nondischargeability applies to both fraud debt and any debt following from the original fraud, the fact that the tax statute lacks such language could explain the need for an
2. Cases Permitting Discharge

The original case permitting discharge of a contract based in fraud, *Maryland Casualty Co. v. Cushing*, arose in 1948. Like so many other fraud cases, *Maryland Casualty* involved a debtor who embezzled from his employer. The debtor executed a promissory note to his employer for the amount embezzled, in exchange for a promise that the employer would dismiss the claims brought against the debtor-employee in state court. Of course, the employee then filed for bankruptcy protection and sought to discharge the obligations under the promissory note. While recognizing that typically "a promissory note is but the evidence of indebtedness and does not discharge the debt for which it was given," the court held that, in this case, the parties intended that the promissory note would substitute a contract debt for the embezzlement debt because it expressly waived the underlying tort claim. Although frequently cited by later courts in the settlement agreement context, *Maryland Casualty* involved a promissory note evidencing indebtedness and, essentially, admitting liability for the underlying tort. Subsequent cases involved actual negotiations between the parties regarding the amount of damages and, typically, releasing the defendant-debtor from liability for the underlying tort.

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129. *Maryland Casualty Co. v. Cushing*, 171 F.2d 257, 258-59 (7th Cir. 1948).
130. *Id.* at 258.
131. *Id.* at 258-59.
132. *Id.* at 258.
133. *Id.* at 258-59. Other courts adopted the same standard outside of the fraud context in determining whether a settlement claim can serve as a dischargeable contract claim. See *In re Anderson*, 64 B.R. 311, 334-35 (1986) (holding that, where a defendant admitted liability for lost funds and signed a promissory note to repay debt, the note substituted for the original tort claim in light of the parties' intentions).
134. *In re West*, 22 F.3d 775, 777 (7th Cir. 1994).
135. *Maryland Casualty*, 171 F.2d at 258.
136. *Key Bar Invs., Inc. v. Fischer* (*In re Fischer*), 116 F.3d 388, 389 (9th Cir. 1997); *West*, 22 F.3d at 777.
In *In re West*, the court again dealt with embezzlement claims. The settlement agreement specifically released the debtor from liability. The court held that, because the language specifically released the embezzlement claim in favor of the settlement obligation, the underlying fraud did not make the settlement agreement nondischargeable. Thus, the Court focused on a different type of "plain language"—the plain language of the contract itself.

Following the precedent set by *West*, the *In re Fisher* decision of the Ninth Circuit held that the settlement of a fraud claim becomes a dischargeable debt in bankruptcy. The *Fischer* court limited its finding to instances where the settlement agreement clearly released the debtor

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137. 22 F.3d 775 (7th Cir. 1994).
138. The nondischargeability of debt for embezzlement stems from 11 U.S.C. § 523(a)(4), which denies discharge for "any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4) (2000). Interestingly, the "to the extent obtained by" language found in § 523(a) does not appear in this section. *Id.* The cases finding settlement agreements nondischargeable focus on the "to the extent obtained by" language as one of the reasons why the fraud continues to taint the settlement obligation. *See supra* notes 122-23 and accompanying text. *See also,* *supra* note 127.
140. *West*, 22 F.3d at 777. The court also sharply criticized the creditor for interpreting the *Greenberg* case as expressly rejecting the holding of the *Maryland Casualty* case: [The creditor's] brief leads the reader to conclude that many courts, including the Eleventh Circuit in *Greenberg v. Schools*, have considered both prongs of the *Maryland Casualty Co. v. Cushing* rule and expressly rejected them, occasionally with direct criticism. As discussed in the previous section, we read the cases much differently. To argue for an extension of case law or for abandonment of certain common law principles is permissible advocacy; to tell a court that other courts have rejected (as distinct from undermined) a common rule is sanctionable if untrue. Nonetheless, [the creditor] argues no more than the holding of *In re Spicer*. While we are neither bound nor persuaded by the *Spicer* decision, we do not believe it is sanctionable to press one court to adopt another's holding.

*Id.* at 779 (citations omitted).
141. *See id.* at 778.
142. *Key Bar Invs. v. Fischer (In re Fisher)*, 116 F.3d 388, 390 (9th Cir. 1997).
from liability for the underlying fraud (or embezzlement) that allegedly occurred.\textsuperscript{143}

C. Supreme Court Fraud Dischargeability Decisions

Although \textit{Archer} provided the first opportunity for the Supreme Court to consider the dischargeability of amounts due pursuant to settlement agreements of fraud claims, the Court has considered fraud dischargeability on a number of occasions over the last twenty-five years.\textsuperscript{144} On balance, these decisions tend to favor protecting innocent creditors over providing a fresh start for debtors.\textsuperscript{145}

In \textit{Brown v. Felsen},\textsuperscript{146} a case frequently cited by courts refusing to discharge settlement debt,\textsuperscript{147} a creditor sued the debtor in state court alleging fraud.\textsuperscript{148} The parties agreed to a consent judgment on the fraud claim.\textsuperscript{149} When the debtor filed bankruptcy, the creditor alleged that the debtor could not discharge the debt under the consent judgment because it resulted from fraud.\textsuperscript{150} The debtor attempted to invoke \textit{res judicata} principles, stating that, because the creditor relinquished the opportunity to litigate the fraud issue in state court, the creditor could not now

\begin{itemize}
  \item \textsuperscript{143} See id. at 390-91. Although it noted that the fraud victim (the creditor) actually drafted the release language, the court did not focus on the identity of the drafter as determinative of dischargeability. See id. Interestingly, the contract also waived a provision of California law that provided that a victim of fraud could sue for unknown fraud claims even after signing the settlement agreement. \textit{Id}. at 390.
  \item \textsuperscript{144} See Kleinberg, \textit{supra} note 5, at 387-89 (discussing pre-\textit{Archer} cases in which the Supreme Court considered fraud dischargeability).
  \item \textsuperscript{145} One interpretation of these cases requires that the fraud discharge exception receive a broad construction, almost inevitably favoring the creditor's interests over those of the debtor:
    \begin{quote}
      The message delivered by the Supreme Court on these occasions has been clear. In deciding cases dealing with the fraud exceptions to dischargeability, courts should effectuate congressional policy objectives by conducting the fullest possible inquiry into the nature of the debt and limiting relief to the honest but unfortunate debtor. . . . Given that the Supreme Court has declared that "the mere fact that a conscientious creditor has previously reduced his claim to judgment should not bar further inquiry into the true nature of the debt," there would seem to be no reason the mere fact that a conscientious creditor has previously reduced its claim to settlement should bar such an inquiry.
    \end{quote}
    Kleinberg, \textit{supra} note 5, at 389-90.
  \item \textsuperscript{146} \textit{Brown v. Felsen}, 442 U.S. 127 (1979).
  \item \textsuperscript{148} \textit{Brown}, 442 U.S. at 128.
  \item \textsuperscript{149} \textit{Id}.
  \item \textsuperscript{150} \textit{Id}. at 129.
\end{itemize}
litigate the issue in federal bankruptcy court.\textsuperscript{151} In a unanimous decision, the Supreme Court held that \textit{res \textit{judicata}} principles did not apply; and the bankruptcy court could consider potential fraud underlying the consent judgment to determine dischargeability of the amounts due to the creditor.\textsuperscript{152} In response to the debtor's argument that the lower court already had determined whether he committed fraud, the Court replied:

By seeking discharge, however, respondent placed the rectitude of his prior dealings squarely in issue, for, as the Court has noted, the [Bankruptcy] Act limits that opportunity to the "honest but unfortunate debtor." ... Section 17a, the focus of this case, provides that certain \textit{types} of debts are not affected by a discharge. These include, under § 17a(2), "liabilities for obtaining money or property by false pretenses or false representations . . . or for willful and malicious conversion of the property of another" and, under § 17a(4), debts that "were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."\textsuperscript{153}

Further, the Court classified the creditor's use of fraud as a defense against the debtor's claim of dischargeability.\textsuperscript{154} Thus, the Court concluded that the creditor had rightfully attempted to defend his claim, and had not alleged a fraud cause of action against the debtor.\textsuperscript{155}

Following the \textit{Brown} decision, which permitted courts to determine fraud underlying consent judgments, the Court next considered what standard to apply in determining the existence of such fraud in \textit{Grogan v. Garner}.\textsuperscript{156} The debtor in \textit{Grogan} sought to discharge a fraud judgment from a jury trial in federal district court by declaring bankruptcy.\textsuperscript{157} In the district court proceeding, the creditor proved fraud by a preponderance of the evidence.\textsuperscript{158} The debtor argued that, although a preponderance of the evidence sufficed to establish fraud at the jury trial, the Bankruptcy Code required a showing of fraud by clear and convincing evidence to deny discharge.\textsuperscript{159} Both the Bankruptcy Court and the district court disagreed, noting that to require the creditor to reestablish fraud in the bankruptcy proceedings:

\textsuperscript{151} Id.
\textsuperscript{152} Id. at 138-39.
\textsuperscript{153} Id. at 128-29.
\textsuperscript{154} Id. at 133.
\textsuperscript{155} Id.
\textsuperscript{157} Id.
\textsuperscript{158} Id.
\textsuperscript{159} Id. at 282.
Would permit the party who loses at a jury trial to have a second day in court on the same issue [on which] he and his opponent were fully heard previously. If permitted, all like cases would result in duplicitous litigation resulting in an unreasonable burden on the bankruptcy court. The Court considered two options – defer to state law to determine the burden of proof, or create a uniform burden of proof to determine fraud dischargeability. In unanimously choosing the latter option, the Court held that the role of the Bankruptcy Court rests not so much in determining the existence of state-law fraud, but in determining the dischargeability of that fraud. To determine dischargeability, the Court found that the creditor need only prove fraud by a preponderance of the evidence. To hold otherwise would unduly burden the creditor—the victim of fraud—and unfairly benefit the dishonest debtor.

In Field v. Mans, the Supreme Court determined whether, and to what extent, a creditor must rely on a fraudulent misrepresentation to establish nondischargeability. Although the debtor argued for a "reasonable reliance" standard, matching the express requirement for showing nondischargeable fraud under section 523(a)(2)(B), the Court opted for the less-demanding, and more creditor-friendly standard of "justifiable reliance."

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160. Id. at 282 n.4 (citing App. to Pet. for Cert. 28a).
161. Id. at 283-84.
162. Id.
163. Id. at 286-87.
164. Id. at 291.
166. Id. at 61.
168. Field v. Mans, 516 U.S. 59, 73-75 (1995). The concurrence also noted that a causation issue remained for the lower courts:

Was the debt in question, as the statute expressly requires, "obtained by" the alleged fraud? . . . Mans ultimately urges that the promissory note to the Fields is, in any event, a dischargeable debt because it was not "obtained by" the allegedly fraudulent letters Mans's attorney wrote to the Fields' attorney months after the debt was incurred. The Fields maintain that they relied on the letters to their detriment, in effect according Mans an extension of credit instead of invoking the due-on-sale clause.

. . . .

It bears consideration whether a debt that would have been dischargeable had the debtor simply transferred the property, in violation of the due-on-sale clause with never a word to the creditor, nonetheless should survive bankruptcy
Finally, in *Cohen v. de la Cruz*, the Court favored creditors by expanding the damages held nondischargeable under section 523(a)(2)(A) to include punitive damages. In *Cohen*, a landlord fraudulently obtained money from tenants in violation of local law. When the tenants sued the landlord, the court ordered the landlord to return the fraudulently-obtained funds and to pay punitive damages. The landlord then filed for bankruptcy protection, and admitted that he could not discharge the portion of the judgment requiring return of the fraudulently-obtained funds. However, the landlord argued for discharge of the punitive damages because he did not obtain those funds through fraud. The Court unanimously disagreed, relying on the Bankruptcy Code's policy of protecting honest debtors, not dishonest ones. The Court reasoned that the punitive damages resulted from the fraud:

The most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of "any debt" respecting "money, property, services, or . . . credit" that the debtor has fraudulently obtained, including treble damages assessed on account of the fraud . . . .

Moreover, the phrase "to the extent obtained by" in § 523(a)(2)(A), as the court of appeals recognized, does not impose any limitation on the extent to which "any debt" arising from fraud is excepted from discharge. "[T]o the extent obtained by" modifies "money, property, services, or . . . credit" —not "any debt"—so that the exception encompasses "any debt . . . for money, property, services, or . . . credit, to the extent [that the money, property, services, or . . . credit is] obtained by" fraud. The phrase thereby makes clear that the share of money, property, etc., that is obtained by fraud gives rise to a nondischargeable debt. *Once it is established that specific*
money or property has been obtained by fraud, however, "any
debt" arising therefrom is excepted from discharge.\textsuperscript{176}
The Court also noted the legislative history surrounding the enactment
of section 523(a)(2)(A).\textsuperscript{177} The fraud discharge exception under the
former Bankruptcy Act of 1898 required an actual judgment of fraud,
and according to the Court, this exception would extend to punitive
damages included within such a judgment.\textsuperscript{178} Because the Bankruptcy
Code expanded the 1898 Bankruptcy Act provisions, the new legislation
likewise included punitive damages.\textsuperscript{179}

The \textit{Grogan}, \textit{Field}, and \textit{Cohen} decisions illustrate the Supreme Court's
central concerns in dealing with fraud dischargeability: punishment of
dishonest debtors and protection of innocent creditors.\textsuperscript{180} \textit{Grogan}
sets the most lenient standard possible for a creditor trying to establish
fraud.\textsuperscript{181} \textit{Field}, while requiring reliance on a misrepresentation to prove
fraud, only requires justifiable, not reasonable, reliance.\textsuperscript{182} And, finally,
one the creditor establishes fraud, \textit{Cohen} extends the fraud
nondischargeability to punitive damages.\textsuperscript{183} In each case, there were two
similar components; a debtor who committed fraud, with no attempt to
make amends for the damage caused, and a creditor, who upon
discovering the fraud, settled for nothing less than a full judgment on the
fraud.\textsuperscript{184} The \textit{Brown} case provides the only departure from this standard,
in that the debtor did resolve the fraud liability issue with the creditor,
who voluntarily allowed the debtor to pay an amount less than full
payment on the fraud.\textsuperscript{185}

\section*{III. ANALYSIS}

Although the Supreme Court focused on the policy of protecting
innocent creditors against fraudulent debtors, the Court and other cases
reaching the same result based their refusal to discharge settlement debt
on a number of things. First, the courts found that the plain language of

\begin{itemize}
  \item \textsuperscript{176} \textit{Cohen}, 523 U.S. at 218-19 (emphais added).
  \item \textsuperscript{177} \textit{Id.} at 221.
  \item \textsuperscript{178} \textit{Id.} at 221-22.
  \item \textsuperscript{179} \textit{Id.} at 221.
  \item \textsuperscript{180} \textit{See id.} at 220-21; Field v. Mans, 516 U.S. 59, 61, 73-75 (1995); Grogan v. Garner,
  \item \textsuperscript{181} \textit{See Grogan}, 498 U.S. at 291 (declaring the standard of proof for the
        dischargeability exceptions to be the ordinary preponderance of evidence standard).
  \item \textsuperscript{182} \textit{Field}, 516 U.S. at 73-75.
  \item \textsuperscript{183} \textit{Cohen}, 523 U.S. at 220-21.
  \item \textsuperscript{184} \textit{See id.} at 215; \textit{Field}, 516 U.S. at 62-63, 77; \textit{Grogan}, 498 U.S. at 281, 291.
  \item \textsuperscript{185} \textit{Brown} v. Felsen, 442 U.S. 127, 128 (1979).
\end{itemize}
section 523(a)(2)(A) dictates nondischargeability of such debts.\textsuperscript{186} Generally, the analysis ends with the plain language of a statute.\textsuperscript{187} However, the courts bolster their conclusions with an analysis of legislative history, prior Supreme Court cases, and policy arguments.\textsuperscript{188} Regarding policy, the courts not only look to the protection policy noted above, but also to the policy of encouraging settlement agreements over litigation.\textsuperscript{189}

Section 523(a)(2)(A) does not provide clear and precise language on the issue of discharge of settlement claims.\textsuperscript{190} Thus, the courts may indeed consider legislative history, judicial history, and policy in determining Congress' intent in enacting the statute.\textsuperscript{191} Upon consideration of each of these factors, it becomes obvious that permitting discharge of settlement agreements entered into honestly can meet Congress' objectives.

\textbf{A. Plain Language of the Statute}

Quite obviously, one should first consider section 523(a)(2)(A) in determining whether to discharge a settlement debt of a fraud claim.\textsuperscript{192} However, the statute does not directly answer the question posed.\textsuperscript{193} It merely refuses discharge for "any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—(A) false pretenses, a false representation, or actual fraud."\textsuperscript{194} Clearly a fraud judgment in state court meets the requirements of section 523(a)(2)(A), but what happens to a settlement debt?\textsuperscript{195} In Archer, the Supreme Court indicated that, because the debt need only arise as a result of money obtained by fraud, once fraud exists, any debt that results from that fraud will become nondischargeable.\textsuperscript{196} This conclusion,
said the Court, follows from the Court’s previous decisions in the Brown and Cohen cases. However, Cohen provides an entirely different set of facts. In Cohen, a fraud judgment existed; punitive damages provided an additional punishment for the fraud. Even if the debtor did not fraudulently obtain the money due as punitive damages, the amount became a debt to the creditor as a result of the fraud. Thus, even following the Cohen interpretation of the statute to include all damages directly linked to the original fraud claim does not automatically lead to nondischargeability of a settlement replacing the fraud claim. In the settlement scenario, the new debt replaces the old debt that would otherwise be owed for the money obtained as a result of fraud, whether or not such fraud even exists. Thus, the statute’s interpretation could easily allow for dischargeability in that the debtor owed the money as a result of a contractual agreement, rather than through the fraud itself. In fact, given that a debtor owes money under a settlement agreement even if the creditor cannot show fraud, it becomes even more obvious that the debt arises from a contract, not from a debt obtained by fraud.

In another interesting twist on statutory interpretation, a number of courts rely on embezzlement cases in determining whether to discharge fraud liability. Maryland Casualty and Giaimo both involved

197. Id. at 320-22.
199. Id. at 215-16.
200. Id. at 218-19.
201. See Cohen, 523 U.S. at 223. Of course, this does not create a situation allowing discharge of only the original fraud debt owed by the debtor to the creditor. See id. For example, although an embezzlement case, Firemen’s Fund Ins. Co. v. Covino provides a situation where fairness requires nondischargeability of a contract debt based in a fraud action. Firemen’s Fund Ins. Co. v. Covino (In re Covino), 12 B.R. 876, 877 (Bankr. N.D. Fla. 1981). Covino embezzled money from his employer; the company received reimbursement for its losses from the insurer, who then subrogated the company’s claim against Covino. Id. When Covino declared bankruptcy, he sought to discharge the debt owed to the insurer, stating that the claim arose not out of nondischargeable embezzlement, but out of a contract between the insurer and Covino’s employer. Id. The court disagreed and held the debt nondischargeable. Id. Even though the debtor did not victimize the creditor, the amounts owed to the creditor resulted directly from the embezzlement itself. Id. However, this case did not involve a situation where the creditor and debtor agreed to replace the fraud claim with a contractual debt obligation. See id. Rather, the debtor, if granted a discharge, would benefit by the fortuitous purchase of insurance by his employer, at the expense of a creditor who agreed to pay the employer, but did not release any claims against the debtor in the process. Id.
202. See AM. JUR. 2d Compromise and Settlement § 1 (2000) (stating that a settlement “involves an agreement that a substituted performance is acceptable instead of what was previously claimed to be due”).
203. See supra notes 146-48 and accompanying text.
204. See, e.g., Greenberg v. Schools, 711 F.2d 152, 155 (11th Cir. 1983)
embezzlement. Although not an embezzlement case, in Greenberg, the court based its analysis on an embezzlement case. However, the embezzlement statute at issue in Greenberg does not include the same "to the extent obtained by" language used to deny discharge of debt existing solely because of underlying fraud. Rather, the embezzlement statute denies discharge only for that debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." This language appears to render the "to the extent" analysis engaged in by the Cohen Court unnecessary because the settlement could receive discharge without such language.

Looking beyond section 523(a)(2)(A), nothing in the Bankruptcy Code prohibits changing the form of a fraud claim shortly before the bankruptcy. The provisions cited by the Francis court, which restrict the ability for a debtor to waive either discharge or the right to file for bankruptcy protection, focus on an entirely different policy than the section 523 denial of discharge. Section 523 denies discharge of fraud debts in order to protect innocent creditors from dishonest debtors. The two provisions noted by the Francis court focus on exactly the opposite concern—protecting the unwitting debtor against unscrupulous creditors. Financially-savvy creditors may easily manipulate debtors on the brink of financial ruin; less concern exists for creditors in their relations with debtors.

Although Congress occasionally prohibits the changing of a claim prebankruptcy in an attempt to protect creditors, it does so not to protect the creditors involved in the transaction, but to protect remaining
creditors.\textsuperscript{215} For example, consider preferential transfer law.\textsuperscript{216} A debtor on the verge of filing for bankruptcy protection may wish to pay preferred creditors to ensure that those creditors receive as much as possible out of the debtor’s limited assets. If that payment allows a creditor to receive a greater amount than it would otherwise receive, a preferential transfer may well exist, and the creditor must remit the preference to the bankruptcy estate.\textsuperscript{217} This provision protects not the creditor who returned the preference, but the creditors who did not receive the preference because more exists for distribution to all creditors in the bankruptcy proceeding.\textsuperscript{218}

The Code’s “to the extent by” language located in section 523(a)(2)(A) provides little clarity as to congressional intent regarding settlement debt on a fraud claim.\textsuperscript{219} Other subsections of section 523 likewise fail to shed light on this issue.\textsuperscript{220} Finally, other provisions of the Code only provide means for protecting debtors, or for protecting innocent creditors against the actions of debtors and other creditors and, thus, do not aid in the interpretation of section 523(a)(2)(A).\textsuperscript{221}

\textbf{B. Legislative History}

Unfortunately, Congress provided little legislative history to guide the analysis of section 523(a)(2)(A).\textsuperscript{222} To the extent that debts cannot receive discharge under section 523(a), Congress decided that “the creditors’ interest in recovering full payment of [such] debts . . . outweigh[s] the debtors’ interest in a complete fresh start.”\textsuperscript{223} Exceptions to discharge exist either to prevent dishonest debtors from avoiding

\begin{itemize}
\item \textsuperscript{215} See 11 U.S.C. § 547(b) (2000). Under § 547, a claim which is amended by the debtor’s prepetition changes may be converted back to the original claim. This ability to recover preferential transfers is designed to protect the remaining creditors from depletion of the estate before bankruptcy is filed. See Butner v. United States, 440 U.S. 48, 55 n.10 (1979).
\item \textsuperscript{216} 11 U.S.C. § 547(b) (2000) (a preference means a transfer of the debtor’s assets within the, usually, 90 days before bankruptcy for the benefit of a creditor that allows the creditor to receive more than he otherwise would).
\item \textsuperscript{217} Id.
\item \textsuperscript{218} See id.
\item \textsuperscript{219} 11 U.S.C. § 523(a)(2)(A) (2000); see also supra notes 191-203.
\item \textsuperscript{220} See 11 U.S.C. § 523 (2000); see also supra notes 203-09.
\item \textsuperscript{221} See supra notes 211-17.
\item \textsuperscript{222} For a discussion of the legislative history, see 11 U.S.C. § 523 (2000) and accompanying text.
\item \textsuperscript{223} Grogan v. Garner, 498 U.S. 279, 287 (1991). See also Zelikoff, supra note 69 at 873-74 (“The purpose of the fraud exception is to discourage fraudulent conduct and to ensure that dishonest debtors do not have the same relief as honest debtors. If the court [held otherwise], this division of benefits between honest and dishonest debtors would no longer exist.”).
\end{itemize}
debts, or to ensure payment of important types of debts.224 The fraud exception clearly fits into the former of these justifications.225 Thus, to the extent that Congress denied discharge to a creditor pursuant to § 523(a)(2)(A), Congress indicates its desire to protect victimized creditors against dishonest debtors.226

In the cases at hand, however, the debtor may not be dishonest. Certainly, the debtor engaged in dishonest behavior at one point in time, but the Supreme Court's newest decision dictates that a dishonest debtor can never become honest again, even if that debtor enters into a settlement agreement with the honest (and reasonable) intention of repaying the debt in full.227

The Brown Court considered the legislative history of section 523(a)(2)(A) or, more accurately, of its predecessor, section 17a of the Bankruptcy Act.228 The original version of the Act denied discharge only for judgments of fraud,229 but five years later, Congress changed it to include liabilities for fraud.230 The Court then cited statements of Congress regarding the statute, and reached the conclusion that such statements required a finding of nondischargeability of any debt resulting from fraud, even if not actually incurred fraudulently.231 To the extent that the statute deleted the requirement of a fraud judgment for nondischargeability, courts may interpret such a change in a number of ways, absent a congressional statement regarding its intention. The Brown Court implied that the change indicated that debtors could not discharge consent judgments on proven fraud. That decision then carried over into the Archer decision prohibiting discharge of settlement agreements in the event of fraud.232

The domino effect may now continue to allow courts to consider fraud in any bankruptcy claim, regardless of the form of that claim when

224. See Radwan, supra note 10, at 992 n.19 (distinguishing between debts nondischargeable as matter of public policy versus debts nondischargeable due to debtor's bad acts).
225. Capital City Bank v. Kroh (In re Kroh), 88 B.R. 987, 992 (Bankr. W.D. Mo. 1988) (noting that the purpose of the fraud exception is "to discourage fraudulent conduct and to ensure that the relief intended for the honest debtor does not inure to the benefit of the dishonest debtor").
229. Id. at 138 (citing 30 Stat. 550).
230. Id. (citing 32 Stat. 798).
231. Id. The Brown Court stated: "The amendment, said the accompanying House Report, was 'in the interest of justice and honest dealing and honest conduct,' and it was intended 'to exclude beyond peradventure certain liabilities growing out of offenses against good morals.'" Id.
232. See id.
entering bankruptcy. Nevertheless, the legislative change could also indicate a desire to hold nondischargeable fraud proven without the need for a lawsuit, for example, because the debtor admitted to the fraud or filed bankruptcy before the entry of a judgment on the merits of the claim. These explanations serve the congressional purpose of punishing dishonest debtors by requiring that debtors who commit fraud pay for that fraud. The Brown Court even cited congressional statements indicating that the change from requiring judgments to only requiring liabilities on fraud prevented dishonest debtors from receiving discharge. But to extend such a nondischargeability determination to a debtor who honestly enters into a settlement agreement simply because that debtor at one time committed fraud does not promote the same congressional ideals and also stretches the interpretation of legislative history beyond permissible boundaries.

C. Supreme Court Jurisprudence

Cases considering discharge of settlement frequently cite the Brown case for the proposition that a bankruptcy court may look to underlying debt to determine dischargeability despite the fact that the parties could have litigated the issue in a non-bankruptcy proceeding. These decisions correctly state the holding of Brown: the principles of res judicata generally do not apply to consent judgments (or settlement agreements). Thus, any claim by the Warners in the Archer case that a bankruptcy court cannot hear the fraud claim due to such principles would fail. However, the court in Brown never considered whether the creditor's claim arising from the consent judgment constituted a contractual debt or a fraud debt. Indeed, it seems odd to think of this case in contract terms because Brown did not involve any contract. True, the parties agreed to the judgment, but unlike a settlement, the Court actually put forth an order—a judgment—noting the debtor's liability for the judgment amount. However, the Archer case differs

233. Id., 442 at 128-29.
236. See Archer, 538 U.S. at 320-23. See also Clark, supra note 55, at 1603 (considering the application of collateral estoppel to settlements or consent judgments); Cuevas, supra note 54, at 24 (discussing the applicability of collateral estoppel in dischargeability proceedings).
238. See id. at 128. Rather, Brown was Felsen's guarantor of a bank loan to finance automobile trading for Felsen's car dealership. Id.
239. Id. at 128.
from the *Brown* case; in an *Archer* situation, no judgment exists, nor will a judgment ever come into existence, short of allowing a bankruptcy court to render one.\(^{240}\) One would face difficulty contending that the settlement agreement does not constitute a contract.\(^{241}\) Thus, the question in the *Archer* case became whether to reconstrue that contract as a fraud debt.\(^{242}\) No such question presented itself in *Brown*.\(^{243}\) Rather, in *Brown*, a judgment debt existed; the bankruptcy court merely needed to determine the nature of that judgment, whether it was fraud or not.\(^{244}\)

Even if one follows the *Brown* reasoning to determine the result in a case like *Archer*, such a result would be inconsistent with other Supreme Court opinions in the fraud dischargeability arena and with the congressional policy of allowing honest debtors the benefit of a discharge. The *Archer* decision fails to follow the constructs of *Grogan*, where the Court stated:

> At the outset, we distinguish between the standard of proof that a creditor must satisfy in order to establish a valid claim against a bankrupt estate and the standard that a creditor who has established a valid claim must still satisfy in order to avoid dischargeability. The validity of a creditor's claim is determined by rules of state law. . . . Since 1970, however, the issue of nondischargeability has been a matter of federal law governed by the terms of the Bankruptcy Code.\(^{245}\)

The *Grogan* decision requires first a state law claim against the bankruptcy estate, and a subsequent finding by the bankruptcy court refusing discharge of the state law claim on the basis of fraud.\(^{246}\) However, in the context of a settlement agreement, no state law fraud claim exists. What exists? A state law contract claim.\(^{247}\) By looking past the state law contract principles to find any underlying fraud in


\(^{241}\) See 15A AM. JUR. 2D *Compromise and Settlement* § 37 (2000) ("A valid compromise and settlement . . . is as binding as any contract the parties could make . . . .")

\(^{242}\) *Archer*, 538 U.S. at 318-19.


\(^{244}\) See *In re DeTrano*, 326 F.3d 319, 322 (2d Cir. 2003) ("Where, however, the judgment does not indicate the cause of action on which liability is based, res judicata does not apply . . . .") (citing *Brown*, 442 U.S. at 133-35).


\(^{246}\) See generally *Grogan*, 498 U.S. at 283-85 (distinguishing between state law determination that a creditor holds a valid claim, and federal law determination that a claim cannot be discharged due to fraud). See also *Ed Schory & Sons, Inc. v. Francis* (*In re Francis*), 226 B.R. 385, 395 (B.A.P. 6th Cir. 1998) (Lundin, J., dissenting) (noting that the decision allows a creditor to charge fraud despite voluntary release of a prior claim).

\(^{247}\) 15A AM. JUR. 2D *Compromise and Settlement* § 36 (2000) (stating that settlement extinguishes prior claims, limiting parties to actions based on the agreement itself).
determining dischargeability, the Archer court essentially created a state law claim for fraud. Consider the disastrous ramifications of such a decision. If a creditor sues a debtor for breach of contract but never brings forth a fraud allegation, and the parties subsequently settle that claim, the bankruptcy court may still determine that fraud existed and hold the settlement debt nondischargeable because fraud is determined separately from the contract claim. This provides a great incentive for creditors to allege fraud in every bankruptcy claim if not entirely frivolous.

However, the Grogan Court sought not to increase litigation, but to avoid it. Grogan provided a lenient standard to creditors in proving nondischargeability to prevent those creditors from being forced to relitigate an already-resolved issue in bankruptcy court. The Grogan decision provided a means for ensuring that a resolution of fraud allegations in state court survives in bankruptcy. To allow a creditor to use the Grogan decision to relitigate previously resolved issues in bankruptcy court destroys the meaning of that decision.

Furthermore, even if Grogan does allow a bankruptcy court to revisit a claim decided by the state courts, as done in Brown, that does not mean courts should reconsider fraud voluntarily abandoned by the parties. The Grogan court repeatedly noted congressional intent to protect victimized creditors from dishonest debtors. Although Grogan involved a debtor found liable for fraud in court, Archer, however,

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248. *Res judicata* might not even apply if the parties fail to settle and actually litigate the issue because the issue would then involve dischargeability, not liability on the claim.

249. The Grogan Court noted this possibility, although it did not resolve what to do with such a case. *Grogan*, 498 U.S. at 285 n.12.

250. See *id.* at 282 n.4.

251. *Id.* at 285. The Court stated:

In sum, if nondischargeability must be proved only by a preponderance of the evidence, all creditors who have secured fraud judgments, the elements of which are the same as those of the fraud discharge exception, will be exempt from discharge under collateral estoppel principles. If, however, nondischargeability must be proved by clear and convincing evidence, creditors who secured fraud judgments based only on the preponderance standard would not be assured of qualifying for the fraud discharge exception.

*Id.*

252. *Id.* at 284-85, 291 (holding that the applicable standard of proof for dischargeability exceptions under 11 U.S.C. § 523(a) is the preponderance of evidence standard). Other factors influencing the Court’s decision included the language of the statute, its structure, and its legislative history. *Id.* at 286-87.

253. *Id.* at 284-85 & n.10.

254. See *id.* at 282 n.4, 284-85.


257. *Id.* at 281.
involved a creditor who, knowing of the possible existence of fraud, chose not to continue pursuing a fraud claim and, instead, accepted a contractual substitute. The debtor did not victimize the Archer creditor in creating the claim as the Grogan debtor did.

Finally, one could interpret the Cohen decision as refusing discharge of any debt somehow resulting from a fraud. In some ways, such an analysis mirrors a causation analysis, where causation-in-fact differs from proximate causation. Causation-in-fact requires only that the second event would not exist "but-for" the first event, while proximate causation requires a legally recognized connection between the two events. Further, proximate cause cannot exist without causation-in-fact, and intervening events may break the chain of causation. In Cohen, causation-in-fact certainly exists—punitive damages could not exist against the landlord absent the original fraud against his tenants. However, that same causation-in-fact may not exist in Archer. The settlement agreement in Archer could exist even without fraud on the part of the Warners; the underlying fraud claim need not be valid or provable for the parties to enter into a settlement agreement. But even if underlying fraud exists, the Archers broke that causal chain by knowing of the underlying fraud and voluntarily terminating that fraud liability.

Prior Supreme Court decisions, then, do not provide a strong basis for the Archer holding. The Brown decision misconstrues legislative history to determine that nondischargeable fraud "liability" includes liability so long as the creditor shows some fraud between the parties. Furthermore, Brown's holding merely states that collateral estoppel and res judicata principles do not apply to consent judgments, without expressly stating that the bankruptcy court can or should revisit the basis.

259. Compare id., with Grogan, 498 U.S. at 281.
263. Id. § 29 (Tentative Draft No. 3, 2003).
264. Id. § 26 (Tentative Draft No. 2, 2003).
265. Id. § 34 (Tentative Draft No. 3, 2003).
268. See id.; supra note 133.
for a voluntary settlement agreement. In addition, in the context of settlement agreements, permitting such considerations by the bankruptcy court undermines the purposes of the Grogan decision to avoid relitigation of resolved issues. Finally, the Cohen decision need not apply in the context of claims resulting from voluntary agreement of the parties.

1. Fear of Dishonest Debtors

The courts had expressed clear concern over the ability of a savvy debtor to convert a nondischargeable fraud debt into a dischargeable contract debt and, essentially, avoid payment on a fraud claim (or at least avoid much payout on a fraud claim). However, courts may render a settlement debt nondischargeable to the extent that a debtor enters into such an agreement just to turn the fraud payment into a contract claim—which thus discharges it—even if the courts do not hold all fraud settlements nondischargeable. It certainly appears suspicious when the debtor files for bankruptcy protection before making even one payment on the settlement agreement. If the debtor's actions amount to bad

271. Id. at 19-20.
272. See supra notes 253, 255-57 and accompanying text.
273. See Cohen v. de la Cruz, 523 U.S. 213, 215-16, 219 (1998) (recounting the procedural history of the case and noting that the plaintiff contested the applicability of § 523 to certain damages, not any type of voluntary agreement).
276. See In re Warner, 283 F.3d 230, 235 (4th Cir. 2002). Proving fraudulent intent presents challenges of its own. In Archer, the Fourth Circuit provided some guidance in making such a claim:

any successful fraud-in-the-inducement contention must establish that Mrs. Warner planned all along to file bankruptcy to escape her contractual settlement commitments with the Archers. The district court doubted such a plan because the Warners had ready [sic] paid $200,000 in cash pursuant to the settlement agreement, and had given deeds of trust on real estate to secure the payment of the note as well.

Id. Though the requirement of establishing fraudulent inducement of the settlement agreement seems burdensome, keep in mind that this article discusses creditors who do not yet hold a fraud judgment against a debtor. Even under the Archer analysis, the creditor seeking an exception to discharge needs to establish fraud under 11 U.S.C. § 523(a)(2)(A). Id. at 235-36. Thus, this standard does not impose much of an additional burden on a creditor seeking to render a debt nondischargeable; it merely changes the form of fraud that the creditor must show. See id. Indeed, showing fraud in the inducement of the settlement agreement may be easier to show if courts extend to § 523(a)(2)(A) the presumption found in another area of the Bankruptcy Code that a debtor knows of his insolvency and pending bankruptcy during the months preceding bankruptcy to § 523(a)(2)(A). See 11 U.S.C. § 547(f) (2000). Rather than establishing that
faith, the bankruptcy court has the authority to dismiss the bankruptcy petition altogether.\textsuperscript{277} Because a debtor cannot receive a discharge without successfully completing the bankruptcy, this remedy not only prevents the debtor from discharging the settlement agreement entered into dishonestly, but also punishes the debtor by preventing him from discharging other debts obtained honestly.\textsuperscript{278} As a result, consistent application of such a tactic will deter future debtors from attempting the same tricks in their own bankruptcy proceedings.

Even without complete dismissal of the bankruptcy proceeding, if the debtor entered into the settlement agreement fraudulently, such as by intentionally misrepresenting his willingness or ability to repay the settlement amount, the debtor cannot discharge damages caused by that fraud.\textsuperscript{279} If a creditor lost the ability to collect on the original fraud claim by entering into the settlement and voluntarily waiving the fraud claim, the damages would include the amount that the creditor could have collected on the original fraud claim itself.\textsuperscript{280} Indeed, this may provide

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the original transaction between the debtor and creditor resulted from fraud, the creditor could show that the settlement transaction originated in fraud to establish nondischargeability. The creditor may then need to show the viability of the original fraud claim as well to establish damages. See \textit{In re Warner}, 283 F.3d at 237.

\textsuperscript{277} See 11 U.S.C. §§ 707(a), 1112(b), 1307(c) (2000). See also Solow v. PPI Enters., Inc. (\textit{In re PPI Enters., Inc.}), 324 F.3d 197, 210 (3d Cir. 2003) (finding that bad faith constitutes cause for dismissal of bankruptcy petition).

\textsuperscript{278} See \textit{PPI Enters.}, 324 F.3d at 210 (stating that bankruptcy courts have the power to dismiss Chapter 11 filings for bad faith, thereby making the debtor responsible for all of his debts).


\textsuperscript{280} But see \textit{In re Baroff}, 105 F.3d 439. In \textit{Baroff}, the debtor agreed to purchase a Ford dealership from the creditors. \textit{Id.} at 440. After some dispute over the financial status of the companies, the parties entered into a settlement agreement, whereby the debtor would pay the creditor $100,000 and obtain all rights to the dealership. \textit{Id.} The agreement expressly released all parties from "any future known or unknown claims." \textit{Id.} When the debtor filed for bankruptcy protection, the creditor sought nondischargeability of the settlement obligation on the basis of fraud. \textit{Id.} However, the creditor alleged fraud not in the underlying agreement to purchase the Ford dealership, but in the settlement agreement itself. \textit{Id.} The creditor argued that the debtor fraudulently induced it to enter into the agreement. \textit{Id.} Looking at California law, the court determined that the agreement’s language releasing the debtor from "all other" claims applied and, thus, the fraudulent inducement claim could not continue. \textit{Id.} at 442. In so holding, the court affirmed the bankruptcy court’s determination that the settlement agreement’s clear language controlled, and that any extrinsic evidence to show the underlying fraud was prohibited under California’s parol evidence rule. \textit{Id.} at 441. Although fraud provides an exception to the parol evidence rule, a number of cases agree with \textit{Ford} and provide otherwise. Lawrence M. Solan, \textit{The Written Contract as Safe Harbor for Dishonest Conduct}, \textit{77 CHI-KENT L. REV.} 87, 110 (2001) (citing cases which hold that fraud is not an exception to the parol evidence rule); Keith A. Rowley, \textit{Contract Construction and
the creditor with even more protection than the Supreme Court established in *Archer* because the creditor now holds a nondischargeable claim limited not to the settlement amount, but to the value of the fraud claim itself, because the misrepresentation on the settlement payment led the creditor to give up its right to reap the benefit of the original fraud claim. Such a solution responds to the concern of the *Archer* dissent, which noted the difficulty in finding that the nondischargeable claim arises out of the tort of fraud, while simultaneously holding that the amount of the claim finds its basis in the settlement contract.

2. *The Essence of Settlement Agreements*

Perhaps the most troubling aspect of the fraud dischargeability decisions involves the essence of settlement negotiations between parties. Settlements provide a variety of benefits, and courts should certainly encourage parties to use such agreements to resolve problems. Although the *Archer* decision may encourage creditors to settle agreements, or at least not discourage settlement, it turns the general understanding of settlements upside-down.

*Interpretation: From the “Four Corners” to Parol Evidence (And Everything in Between),* 69 Miss. L.J. 73, 269-73 (1999).

281. See 11 U.S.C. § 523(a)(2)(B) (2000). To the extent that the debtor makes materially false written statements regarding his financial condition, the fraud also falls under § 523(a)(2)(B), which expressly makes such statements nondischargeable if the creditor relied upon them.


283. 15A AM. JUR. 2D Compromise and Settlement §§ 5-6 (2000).

284. *Archer*, 538 U.S. at 323 (finding settlement debt arising out of “false pretenses, a false representation, or actual fraud” non-dischargeable even where the settlement agreement “may have worked a kind of novation”). The concern of creditors’ attorneys becomes readily apparent in the advice given by them:

> Where a creditor has been a victim of fraud, especially where the amount of the loss is significant, that creditor should literally race to the courthouse to commence, prosecute and obtain a final judgment before the defendant files bankruptcy and should not compromise the fraud claim without a consent decree attesting to the nondischargeability of the settlement obligation . . . .

A settlement structured against a backdrop where the creditor has gone through the steps of obtaining a judgment under section 523(a)(2) of the *Bankruptcy Code* can then be structured as a simple forbearance agreement that will be honored by the creditor only so long as the defendant/obligor makes the required installment payments towards the agreed upon compromise amount.

Rebecca Callahan & Lisa Mathaisel, *Contracting Around § 523 of the Bankruptcy Code: Is There an Iron-Clad Way To Create a Non-Dischargeable Settlement Obligation?*, 45 ORANGE COUNTY LAW. 35, 41-42 (Apr. 2003). Other alternatives exist to the suggested “trial and forbearance.” *Id.* The parties can settle, but release claims only after payment in full, or, perhaps, settle with the express proviso that the settlement will not be deemed a contract in bankruptcy. This article does not suggest the enforceability of such a provision
Parties enter into settlement agreements for a variety of reasons. Perhaps parties wish to avoid bringing forth embarrassing or sensitive information in court. Perhaps they do not know the strength of their respective cases and prefer the certainty of a settlement. Perhaps they know the weaknesses of the case and expect to receive more in a settlement than in a judgment. Perhaps they wish to speed up the resolution by avoiding trial. Perhaps the creditor, aware of the debtor's precarious financial position, deems it better to receive a paltry amount in settlement than to allow the debtor to spend all of its resources litigating a fraud claim and become unable to pay the judgment thereon. Regardless of the reasons for entering into a settlement, such a settlement serves one primary purpose; it brings certainty to the

by the bankruptcy courts; the courts would need to determine if such a provision unduly prevents the debtor from filing for bankruptcy protection in the first place. See, e.g., 11 U.S.C. § 365(e)(1) (2000) (rendering provisions based on bankruptcy or insolvency unenforceable in executory contracts). However, if permitted, such a provision protects creditors without foregoing settlement altogether and without the necessity of litigation.

285. See Archer, 538 U.S. at 322-23. How to best effectuate the policy of encouraging settlements received much analysis in the courts considering the fraud dischargeability issue. See supra notes 38-43, 70 and accompanying text. Creditors may avoid settlement if the debtor could discharge such debt. See supra note 70 and accompanying text. Debtors who cannot discharge a settlement agreement upon a showing of fraud may not find any benefit in settlement. See Brief for AARP, supra note 49, at 6. The latter rationale received some well-deserved criticism in that the debtor loses little by settling. See id. If the court denies discharge of the settlement amount because of a showing of fraud, the debtor's position remains the same as if the debtor had litigated the claim, but the creditor receives a judgment of fraud against the debtor, as well as a finding of nondischargeability of the resulting fraud liability. To some extent, this ignores the fact that settlement costs money, and if the debtor settles and subsequently must litigate the fraud issue in bankruptcy court, it costs even more. However, courts probably will offer little sympathy to the debtor entering into the settlement agreement with knowledge of a pending bankruptcy filing.

286. 15A AM. JUR. 2d, Compromise and Settlement, § 6 (2000) (noting that parties favor settlements because they are “faster and less expensive” than lawsuits and promote “amicable and peaceful relations” between litigants).

287. The Brown Court noted this possibility:

So long as a debtor is solvent, the debtor and creditor alike may prefer a simple contract suit to complex tort litigation. Default and consent judgments are common in collection proceedings. For the creditor, the prospect of increased attorney’s fees and the likelihood of driving the debtor into bankruptcy may offset the advantages of exemplary damages or other extraordinary remedies. Bankruptcy deprives the debtor of his creditworthiness and so impairs his ability to repay. In the words of a Shakespearean creditor, fearing the worst: “When every feather sticks in his own wing, Which Lord Timon will be left a naked Gull, Which flashes now a Phoenix.”

otherwise unpredictable world of litigation. Ultimately, the parties "agree[] that a substituted performance is acceptable instead of what was previously claimed to be due; thus, each party yields something and agrees to eliminate both the hope of gaining as much as he previously claimed and the risk of losing as much as the other party previously claimed." At the heart of settlement lies the willingness of each party to give up something, such as a right to more money or, perhaps, a claim of nondischargeability, in exchange for something else, such as certainty.

Settlement agreements arise in contract and enforcement requires meeting the required elements of a contract. Assuming that the parties

288. By "unpredictable," the author does not intend to imply that the judicial process creates flawed or unfair results. Even with a perfectly-conducted trial, one cannot always predict the decision of a jury or judge. Cf. R. Perry Sentell, Jr., The Georgia Jury and Negligence: The View from the Trenches, 28 GA. L. REV. 1, 77-78 (1993) (arguing that because jury verdicts rely on the composition of the jury, settlements tend to create more fair results).

289. 15A AM. JUR. 2D Compromise and Settlement § 1 (2000).

290. See id. at § 29 (arguing that a settlement agreement must include "mutual concessions").

291. Id. § 9. Because settlement agreements exist as contracts, another issue that periodically arises involves whether the settlement agreement constitutes an executory contract subject to § 365 of the Bankruptcy Code. See Jay Lawrence Westbrook, A Functional Analysis of Executory Contracts, 74 MINN. L. REV. 227, 229-31, 249-50 (1989). Executory contracts include those contracts on which some performance remains due from each party to the contract, though many interpretations of "some performance" exist. Id. at 236-37, 243. For each settlement agreement, the court must consider the facts of the case to determine the application of executory contract law. See Enter. Energy Corp. v. United States, 50 F.3d 233, 238, 241, 244 (3d Cir. 1995) (finding that a prepetition settlement agreement between debtor and creditor was not an executory contract); Jenson v. Cont'l Fin. Corp., 591 F.2d 477, 481 (8th Cir. 1979) (concluding that a settlement agreement between debtor and creditor was an executory contract). The decision to apply executory contract law adds yet another layer of decision-making for the court because the trustee or debtor-in-possession has the exclusive right to choose whether to continue under the terms of the contract, subject to the court's approval of that choice. 11 U.S.C. §§ 365(a), 1107(a) (2000). If the debtor chooses to continue under the terms of the contract, the dischargeability question becomes moot because the parties must comply with the contract in all respects. See A. Mechele Dickerson, From Jeans to Genes: The Evolving Nature of Property of the Estate, 15 BANKR. DEV. J. 285, 305 n.107 (1999) (discussing debtor's obligations in an assumed executory contract). In choosing not to continue under the terms of the contract, however, the debtor and creditor may find themselves considering the implications of the Archer decision, for rejection of a contract constitutes breach of the contract, creating a claim against the bankruptcy estate. 11 U.S.C. § 365(g) (2000). In some sense, the Archer decision may render the debtor's choice somewhat less important; in either assumption or rejection, the debtor will remain indefinitely liable for the amounts due under the settlement agreement.

292. 15A AM. JUR. 2D Compromise and Settlement § 10 (2000). These elements include: offer, acceptance, consideration, and "mutual assent." Id. Another possible argument for a creditor trying to avoid discharge of settlement obligations may stem from
included all these elements and agreed to all essential terms in the contract:

A valid compromise and settlement is final, conclusive, and binding upon the parties and upon those who knowingly accept its benefit. It is as binding as any contract the parties could make, and as binding as if its terms were embodied in a judgment. A compromise and settlement generally is binding upon the parties although it resolves a controversy differently from what the court would have decided if the controversy had been brought before it for decision.\(^\text{293}\)

In some sense, by entering into a settlement agreement, parties create their own res judicata and claim preclusion, thus dictating their own resolution of the fraud issue.

Of course, not every settlement agreement involves an agreement between the parties to substitute the settlement contract for the original tort claim. Courts allowing discharge of a settlement agreement focus on the existence of such a release of the debtor within a settlement agreement.\(^\text{294}\) Without such a release, courts typically find that the debtor's liability for fraud under state law continues.\(^\text{295}\) If state law fraud

the mutual assent requirement. See id. § 11 ("A valid compromise requires the mutual assent of the parties, and a meeting of the minds on all the essential terms of the agreement."). Assuming that the dischargeability of the debt in the event of a bankruptcy constitutes an essential term of the settlement agreement, the failure of the parties to agree on such dischargeability would indicate a lack of mutual assent between the parties. See id. §§ 11, 39; E. Allan Farnsworth, Farnsworth on Contracts § 3.1 (2d ed. 1998). Without such assent, a court cannot enforce the settlement agreement. See 15A Am. Jur. 2d Compromise and Settlement §§ 10, 39 (2000). Thus, because of the absence of a contract in the form of a settlement between the parties, the creditor is able to bring forth the original fraud claim. See id. §§ 11, 39.


295. Even this issue, however, creates controversy. In some situations, the debtor alleges mere oversight in the omission of release language with regard to a particular debt, or that the language that the parties used as a release included all claims. Courts disagree in such circumstances. When release language exists, but merely neglects to include one or more claims against the debtor, some courts look to the language of the contract and refuse to release the excluded claim. See, e.g., Ellis v. Univ. of Kan. Med. Ctr., 163 F.3d 1186, 1199-1202 (10th Cir. 1998). Others look to the intent of the parties to determine whether a reasonable person would expect release of the additional causes of action. Main Line Theatres, Inc. v. Paramount Film Distrib. Corp., 298 F.2d 801, 803 (3d Cir. 1962). The Third Circuit took the Main Line decision one step further, declaring that the release automatically operates to release all other claims because the settlement agreement itself acts as a final judgment in the lawsuit, invoking res judicata-like principles. See Grimes, 17 F.3d at 1553. The Main Line court even went so far as to hold that, even where the parties have only an agreement to dismiss the pending lawsuit without an express release of claims, that a release exists because, "a reasonable person
liability exists, courts cannot discharge it against the creditor's wishes under bankruptcy law. Courts frequently use the term "novation" to describe the release of claims, although technically a novation involves the substitution of one party for another within a contract. Agreements may instead withhold release of the original claim until full payment of the settlement amount. As such, creditors may protect themselves from dischargeability; by using such a provision, nothing limits the creditor to receiving only the contracted-upon amount of the claim. To the extent not paid in full, the creditor may pursue the original fraud claim and collect the corresponding damages.

However, the situation at hand involves a release. The creditor foregoes the ability to later claim fraud in exchange for a sum certain. The debtor gives up that sum certain in exchange for relief from the fraud allegations. These negotiations indicate a clear intent of the parties to avoid litigation of the underlying tort claim. Unfortunately, these agreements rarely indicate the intent of the parties if a bankruptcy later ensues. Thus:

The primary issue, then, is not a matter of "freedom to enter into settlement agreements" as posited by the Warner majority [Circuit Court]. . . . Rather, the issue is faithful interpretation of contractual intent. When the parties make no specific mention of bankruptcy or dischargeability issues in a general release of claims, is the more realistic presumption that the parties did or did not intend to release any claim of nondischargeability in the

agreeing, without any expression of limitation, to accept a sum in settlement of the litigation should and reasonably would understand that both aspects of the suit were covered by the settlement . . . ." Main Line, 298 F.2d at 803. Under the Archer decision, this line of cases becomes irrelevant for, regardless of what the parties release, the courts can consider the fraud. See Archer v. Warner, 538 U.S. 314, 318-320 (2003).

296. See Archer, 538 U.S. at 323-27 (Thomas, J., dissenting).

297. See supra note 42. To some extent, the use of the term "novation" in describing the effect of a settlement agreement makes sense; the "compromise or settlement often will have the same effects as a novation or release." 15A AM. JUR. 2D Compromise and Settlement § 3 (2000).

298. See 15A AM. JUR. 2D Compromise and Settlement § 48 (2000). Section 48 states: A compromise agreement may be classified either as an "executory accord," where it operates as a satisfaction of an antecedent claim only when performed, or as a "substituted contract," where it operates as an immediate substitution for and extinguishment of an antecedent claim. Such distinction may be important where a compromise agreement is not fully performed, because the remedies for breach of an executory accord may differ from the remedies for breach of a substituted contract. The parties' intention generally may determine whether a compromise agreement has the effect of an executory accord or a substituted contract . . . .

Id.

299. See id.
event that the debtor fails to pay the agreed settlement amount? The issue becomes assuming what the parties intended in the event of bankruptcy, and determining whether the parties can rebut that determination through language in the settlement agreement. In Archer, the Court did not discuss the intent of the parties, but instead determined that congressional intent led to a denial of dischargeability. As noted, congressional intent provides little in the way of definitive answers to this problem.

Starting with the primary concern of Congress and the courts—the protection of innocent creditors against dishonest debtors—leads naturally to a conclusion that the intent of the parties should reign in determining dischargeability of settlement debt. If a defrauded creditor contractually allows discharge of an otherwise nondischargeable claim, nothing in the Code should interfere.

The next concern becomes whether to presume that, in the absence of language dictating the dischargeability of a debt, a settlement agreement operates as a waiver of nondischargeability of the underlying fraud claim. As already noted, parties to a settlement agreement expect that, in releasing underlying fraud claims, they will never need to litigate the issue of fraud. A presumption that the creditor who waives nondischargeability in a settlement agreement also waives liability for fraud comports with such an understanding. A contrary presumption forces parties to litigate whether fraud occurred. Although the

300. Contractual Settlement Agreements as to the Dischargeability of the Settlement Debt, BANKRUPTCY LAW LETTER (West Group), June 2002, at 8.
303. See BANKRUPTCY LAW LETTER, supra note 300, at 8 (arguing that courts should focus on "discerning the intent of the contracting parties in entering into the settlement and release," and noting that a creditor must be permitted to contractually abandon its right to nondischargeability of fraud debt).
304. See Archer, 538 U.S. at 326-27 & n.2 (Thomas, J., dissenting) (stating that creditors may waive claims of nondischargeability). But see Bank of China v. Huang (In re Huang), 275 F.3d 1173, 1177-78 (9th Cir. 2002) (declaring that debtors may not waive the right to dischargeability prior to filing a bankruptcy petition).
305. See Archer, 538 U.S. at 315.
306. The new litigation presents other problems because it occurs in a different court than the parties originally contemplated. In Bankruptcy Court, the burden of proof for fraud claims may differ from that in other courts. See Grogan v. Garner, 498 U.S. 287, 287-88 (1991). In addition, although bankruptcy courts may conduct jury trials pursuant to 28 U.S.C. § 157(e) (2000), they rarely do so. See generally G. Ray Warner, Katchen Up in Bankruptcy: The New Jury Trial Right, 63 AM. BANKR. L.J. 1, 1, 2 (1989) (arguing that right to trial by jury should be identical in bankruptcy court and state court). By filing a proof of claim as required in either a Chapter 7 or Chapter 13 case (or a Chapter 11 case if
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litigation serves the purpose of determining dischargeability, it still creates essentially the same litigation and uncertainty that the parties sought to avoid by the original settlement agreement. Thus, if the parties intended to avoid a determination of the existence of fraud, the courts should also presume that the parties intended to avoid a determination of the existence of fraud as the basis of nondischargeability. Parties should be able to rebut such a presumption; courts should allow the creditor to bring forth evidence that the parties intended the settlement agreement to create a contract debt only as to a determination of fraud liability, not as to a determination of dischargeability, thus permitting the court to determine the consequences of such intent.

3. Effect on Debtors and Creditors

Consider again our three debtors, Adam, Brian, and Chris. Under the Archer analysis, each situation results in a nondischargeable claim, in the amount of $50,000 (the remainder due under the settlement agreement), less any amounts paid through the bankruptcy proceeding. A creditor with a settlement agreement differs from a creditor with a fraud claim in that the former realizes the extent of the fraud and chooses to abandon that claim in favor of a contract. Nonetheless, the Archer Court treats these types of creditors in an identical manner in rendering the debt nondischargeable upon a showing of fraud.

Adam entered into the settlement agreement misrepresenting his willingness and ability to pay the agreed-upon amounts, and receiving an express release of his liability for fraud regarding the sale of his business. Under the analysis presented herein, Adam would receive a discharge of the $50,000 still due under the settlement agreement, a contract debt. However, Adam clearly represents the dishonest debtor. What protection, then, does the creditor enjoy? The creditor still enjoys the ability to receive a nondischargeable fraud claim against Adam. The claim exists pursuant to the settlement agreement that Adam fraudulently induced the creditor to enter into, rather than pursuant to the sale agreement which the parties already settled.

Next, what damages should the creditor receive? The existence of the settlement agreement and, more specifically, the release located therein, the scheduled claim amount is disputed) pursuant to FED. R. BANKR. P. 3002, the creditor submits to the bankruptcy court's jurisdiction and gives up the right to a jury trial. NORTON, supra note 17, at § 4:138 (citing Langenkamp v. Culp, 498 U.S. 42 (1990), reh'g denied, 498 U.S. 1043 (1991)). In addition, dischargeability proceedings constitute equitable actions in bankruptcy, which typically do not invoke a right to jury trial. NORTON, supra note 17, at § 4:138 (citing Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989)) ("The creditor is thus faced with a Hobson's choice of either foregoing distributions on its claim or waiving a right to a trial by jury on the claim of the debtor or trustee.").
prevented the creditor from bringing forth a fraud claim against Adam and from receiving the damages available under state law as a result of that fraud claim. The creditor, therefore, should receive the lost damages as compensation for Adam's fraud regarding the settlement agreement. Thus, the creditor receives not only the settlement amount, the limit of the damages under the Archer analysis, but the full amount due under the original fraud claim!

Next, consider Brian. Like Adam, Brian received a release of the alleged fraud in the sale of his business. However, unlike Adam, Brian entered into the settlement agreement with the full intent to repay the settlement amount. Will the remainder due under the settlement agreement receive a discharge? The intent of the parties reigns. But, without an express indication of that intent within the contract, the courts must determine that intent. By presuming (absent evidence to the contrary) that the parties intend the natural consequences of the contract—discharge—upon releasing the underlying fraud, Brian receives a discharge of the amount due under the settlement agreement. Of course, this harms the creditor who will never receive anything more. But this creditor voluntarily released Brian from his fraud liability knowing full well of Brian's alleged fraud. The creditor chose to settle the case for whatever reason and expressly gave up the ability to claim fraud later. Congress need not protect a creditor with such knowledge.

Finally, consider Chris, who entered into the settlement agreement honestly, but failed to secure a release from the underlying fraud. Chris's failure to pay the settlement amount renders Chris liable for the underlying fraud. This mirrors the intent of the parties in entering into the settlement agreement because the fraud persists as a viable claim until full payment of the settlement amount. As with Adam, the creditor may receive a judgment for damages caused by the fraud in the original sale agreement. Unlike Adam, however, these damages result directly from that original fraud, rather than from fraud in the subsequent settlement agreement.

307. A question unanswered at this time, but certainly worth discussion, asks whether the payment of a portion of the settlement through a bankruptcy constitutes payment in full of a claim. If so, Chris performed fully under the contract, leaving his creditor with no ability to seek damages on account of the fraud, even though the settlement agreement release did not take effect immediately upon the signing of the settlement agreement. Given that the parties' agreement protects the creditor until full payment of the settlement amount, to effectuate the intent of the parties requires holding Chris liable for the unpaid amounts under the settlement agreement. This comports with § 524(a) of the Bankruptcy Code, which renders a creditor unable to sue for amounts claimed in the bankruptcy. See 11 U.S.C. § 524(a) (2000). Because the contract served as the basis for the claim in bankruptcy, but fraud serves as the claim in the subsequent action, the creditor's action does not constitute a post-bankruptcy attempt to collect debt discharged in the bankruptcy.
As these three hypothetical debtors illustrate, debtors who attempt to resolve a prior dishonesty through settlement lose the most in the Archer analysis and gain the most by the analysis proposed herein, which focuses on presumptions regarding the intent of the parties, and alternative means of punishing dishonest debtors and protecting victimized creditors. If Congress intends to provide discharge for honest debtors, Brian should fall within that category as soon as he makes honest amends for any prior infractions. Creditors who deal with dishonest debtors like Adam still receive such protection under the fraud nondischargeability provisions. As for Chris, this analysis would inevitably lead to a keener awareness on the part of debtors and creditors as to the effects of settlement of fraud claims in bankruptcy proceedings.

IV. CONCLUSION

As noted by the Archer dissent, one odd aspect of the Archer decision involved the lack of a link between the evidence presented and the damages sought as nondischargeable.\textsuperscript{308} Once the creditor shows fraud, and the debtor becomes forever liable as a result, why limit the damages to something less than the damages caused by that fraud? To do so essentially admits that the parties entered into a binding contractual settlement, without giving that settlement its full effect.

Parties enter into settlement agreements to provide certainty.\textsuperscript{309} Each party accepts the payment of a sum certain to avoid the risks of litigation, the time of litigation, and the expense of litigation.\textsuperscript{310} The Archer decision removes these burdens, and forces the parties to litigate the very issues they avoided by the settlement—simply to determine whether the amounts due under the settlement should continue to exist. Thus, though the parties will essentially engage in the same litigation as if no settlement occurred, the object of the litigation changes dramatically. In this instance, the maximum recovery becomes the settled-upon amount, not the fraud damages, and the minimum recovery becomes the amount already paid under the settlement agreement, rather than nothing. This odd situation arises because the courts essentially straddle the line between tort and contract, allowing the tort claim while still enforcing the contract. In so doing, the courts fail to consider the realities of settlement and the desire of the parties to avoid litigation. Courts need not abandon the parties' intent simply to protect those creditors victimized by a dishonest debtor who enters into a settlement agreement simply to change fraud debt into dischargeable contract debt. The use of

\textsuperscript{308} See Archer, 538 U.S. at 323-24 (Thomas, J., dissenting).
\textsuperscript{309} See supra note 289.
\textsuperscript{310} See supra note 289.
bad-faith filing or fraud claims in the creation of the settlement agreement protects the creditor victimized by such a debtor, while allowing more honest debtors the benefit of discharge.