

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re

GLENN SAMUEL MARTIN
d/b/a TRI-STATE FARM
EQUIPMENT,

Debtor.

No. 99-22580
Chapter 11

GLENN SAMUEL MARTIN,

Plaintiff,

vs.

UNITED STATES OF AMERICA
DEPARTMENT OF AGRICULTURE,

Defendant.

Adv. Pro. No. 00-2052

M E M O R A N D U M

APPEARANCES :

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

In this adversary proceeding, the debtor seeks a determination of dischargeability under 11 U.S.C. § 523(a)(7) which excepts from discharge a fine, penalty, or forfeiture owed to a governmental unit to the extent the obligation is not compensation for actual pecuniary loss. The debt in question is a tobacco marketing quota penalty assessed against the debtor by the United States Department of Agriculture ("USDA") pursuant to 7 U.S.C. § 1314(a).¹ The parties have submitted this proceeding to the court on stipulations of fact and cross-motions for summary judgment. For the reasons discussed below, the court concludes that the penalty in question meets the nondischargeability requirements of § 523(a)(7). Therefore, the court will grant the United States' summary judgment motion and deny the debtor's. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(I).

¹This statute provides in pertinent part that "[t]he marketing of ... any kind of tobacco in excess of the marketing quota for the farm on which the tobacco is produced ... shall be subject to a penalty of 75 per centum of the average market price (calculated to the nearest whole cent) for such kind of tobacco for the immediately preceding marketing year. Such penalty shall be paid by the person who acquired such tobacco from the producer but an amount equivalent to the penalty may be deducted by the buyer from the price paid to the producer" 7 U.S.C. § 1314(a).

I.

According to the joint stipulation of facts, prior to 1993 the debtor operated tobacco warehouses in several states. In connection with these operations, the debtor was indicted by the federal government for "stealing and illegally acquiring over-quota tobacco using fraudulently obtained tobacco marketing cards." As a part of a plea agreement, the debtor plead guilty to "several counts of fraud and conspiracy arising out of his conduct in Georgia, North Carolina, Tennessee, and Virginia" and was sentenced to forty-two months imprisonment.

While the criminal case was pending but prior to the entry of the guilty plea, the USDA assessed the debtor "a tobacco marketing quota penalty in the amount of \$1.8 million for commingling and false identification of burley tobacco produced in Kentucky and marketed through [the debtor's] Tennessee warehouse between November 1986 and January 1987." When the government sued in federal district court to collect the penalty, the court dismissed the complaint on the basis that the penalty violated the double jeopardy clause of the United States Constitution. See *U.S. v. Martin*, No. 2:93-CV-317 (E.D. Tenn. March 21, 1995). On appeal, the Sixth Circuit Court of Appeals reversed, concluding that the assessed penalty was not punishment for purposes of the double jeopardy clause and that

the penalty related to different misconduct than the criminal charges. See *U.S. v. Martin*, 95 F.3d 406, 408 (6th Cir. 1996). Upon remand to the district court, judgment was entered in favor of the United States.

On October 14, 1999, the debtor filed for bankruptcy relief under chapter 11, commencing the underlying case. Based on the judgment granted it by the district court, the USDA has filed a proof of claim in the amount of \$2,972,830.37, which presumably consists of the penalty plus interest. On November 6, 2000, the debtor initiated the present adversary proceeding, seeking a determination of dischargeability with respect to his obligation to the USDA.

II.

Section 523(a) of the Bankruptcy Code provides in pertinent part that:

A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

...
(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss

11 U.S.C. § 523(a)(7). The Sixth Circuit Court of Appeals has explained that “[t]o fall within the provisions of this section,

a debt must satisfy three requirements: (1) it must be 'for a fine, penalty, or forfeiture'; (2) it must be 'payable to and for the benefit of a governmental unit'; and (3) it must not be 'compensation for actual pecuniary loss.'" *Tennessee v. Hollis (In re Hollis)*, 810 F.2d 106, 108 (6th Cir. 1987).

The United States asserts that the obligation in the instant case easily meets the first two requirements because it is characterized as a penalty in the statute under which it was assessed and is payable to the United States. The government maintains that the only arguable element is whether the debt is "compensation for actual pecuniary loss," but that it is not because the penalty was "designed to deter over-production; it [was] not designed to compensate actual pecuniary loss or to reimburse the government its costs of prosecution."

The debtor, on the other hand, does not specifically state which of the three requirements are not satisfied. Instead, he contends that the critical inquiry is whether the assessment is "penal or pecuniary in nature." According to the debtor, if the assessment is penal, it falls within § 523(a)(7) and is excepted from discharge, but if pecuniary, it is dischargeable. The debtor asserts that based on the Sixth Circuit's determination that the assessment in question was not punishment, the assessment is pecuniary in nature and thus dischargeable. As an

additional indication of the nonpunitive nature of the assessed penalty, the debtor points to the fact that the penalty statute in question, 7 U.S.C. § 1314(a), permits the person who acquired the excess tobacco from the producer to recover the cost of the penalty from the producer. The debtor asserts that this statutory ability to "pass on" the penalty is inconsistent with the concept of punishment.

The government's response is that § 523(a)(7) does not mandate the penal/pecuniary distinction. The United States notes that the Sixth Circuit's conclusion that the assessment in question was not punishment was solely "for purposes of the Double Jeopardy Clause." The government states that the United States Supreme Court has observed that all penalties are, in a sense, punitive, citing *Hudson v. U.S.*, 522 U.S. 93 (1997); but that a penalty can be punitive in nature and also not be compensation for "actual pecuniary loss" within the meaning of § 523(a)(7).

The United States is correct in its assertion that the penal/pecuniary dichotomy urged by the debtor does not in and of itself determine § 523(a)(7) dischargeability. Granted, several courts have utilized a penal versus pecuniary analysis in determining whether a debt is excepted from discharge under § 523(a)(7). See, e.g., *Renfrow v. Kentucky (In re Renfrow)*, 112

B.R. 22, 23-24 (Bankr. W.D. Ky. 1989). More importantly, the Sixth Circuit in *Hollis*, while resolving the question of whether court costs imposed as a condition of probation were nondischargeable under § 523(a)(7), did express the issue as whether the debt was "a penal sanction or rather a pecuniary measure designed to compensate the State for the expense it had incurred in prosecuting the criminal action against appellee." *In re Hollis*, 810 F.2d at 108. Despite this characterization of the issue, the court found that the costs assessment was both pecuniary and penal: penal because it was part of the appellee's criminal sentence and pecuniary because it was intended to compensate the State for its expenses in the criminal action. *Id.* Notwithstanding the conclusion that the court costs were pecuniary in part, the Sixth Circuit held that the costs were nondischargeable under § 523(a)(7) based on the directive from the United States Supreme Court in *Kelly v. Robinson* that "§ 523(a)(7) preserves from discharge any condition a state criminal court imposes as part of a criminal sentence." See *In re Hollis*, 810 F.2d at 108 (quoting *Kelly v. Robinson*, 479 U.S. 36, 49 (1986)). Thus, *Hollis* illustrates that a penalty may in some respects be both penal and pecuniary, yet fall within § 523(a)(7).

In its more recent decision on the issue of § 523(a)(7)

dischargeability, the Sixth Circuit Court of Appeals made no reference to the penal/pecuniary distinction. See *U.S. v. WRW Corp.*, 986 F.2d 138 (6th Cir. 1993). Unlike the criminal restitution debt at issue in *Hollis, WRW Corp.* concerned the dischargeability of civil penalties assessed by a federal administrative agency such as in the present case. And, as in the present case, the debtor therein not only argued that his civil penalty was dischargeable under § 523(a)(7), he also asserted that the imposition of civil penalties following his criminal conviction amounted to a violation of the double jeopardy clause. The Sixth Circuit rejected both of these arguments. *Id.* at 140.

With respect to the double jeopardy argument, the court concluded that the civil penalties assessed for violation of safety standards under the Federal Mine Safety and Health Act were remedial rather than punitive in nature, in that no finding of scienter was required in order for the penalty to be assessed, the penalty had a remedial purpose of promoting mine safety, and the amount of the penalty was not so excessive as to constitute a second punishment. *Id.* at 141-42. Regarding the dischargeability issue, the court held that the penalty was nondischargeable under § 523(a)(7) despite its conclusion with respect to the double jeopardy issue. In resolving the

dischargeability question, the court did not address the first two requirements of § 523(a)(7), that the debt be a "fine, penalty, or forfeiture payable to and for the benefit of a governmental unit." Instead, the court focused solely on the last requirement, that the debt not be "compensation for actual pecuniary loss." In this regard, the court stated:

We conclude that the penalty at issue is not compensation for actual pecuniary loss even though it is rationally related to the goal of making the Government whole by roughly compensating it for prosecutorial and investigative expenses. Concededly, this is a fine distinction. Had the size of the penalty been calculated according to proof of actual pecuniary loss, it would not be excepted from discharge under § 523(a)(7).

Id. at 145.

The Sixth Circuit's decision in *WRW Corp.* is particularly relevant to the case at hand. *WRW Corp.* illustrates that a civil, nonpunitive penalty may be nondischargeable under § 523(a)(7).² *WRW Corp.* also establishes that a determination that

²Similarly, courts from other jurisdictions have concluded certain debts may meet the § 523(a)(7) dischargeability requirements even though they are civil and remedial, rather than criminal and punitive in nature. See, e.g., *Durham Inland Wetlands & Watercourses Agency v. Jimmo (In re Jimmo)*, 204 B.R. 655, 658 (Bankr. D. Conn. 1997) (\$100 per day fine imposed as a consequence of the debtor's noncompliance with the state's inland wetlands and watercourses act fell within the ambit of 11 U.S.C. § 523(a)); *Matter of Kent*, 190 B.R. 196, 202 (Bankr. D.N.J. 1995) (motor vehicle surcharges imposed for violation of state motor vehicle laws were nondischargeable penalties within

(continued...)

a penalty is not a punishment for double jeopardy purposes does not in and of itself preclude a finding of nondischargeability under § 523(a)(7). Accordingly, the debtor's assertion to the contrary is without merit.

Because the penal/pecuniary analysis is not determinative of § 523(a)(7) dischargeability, the court must ascertain whether the debt in question satisfies the three stated requirements of § 523(a)(7). In order to do so, it is first necessary for the court to review the statutory scheme under which the debt arose. Fortunately, this was undertaken by the Sixth Circuit Court of Appeals in its review of the district court's decision in *Martin*. As stated by the court therein:

The production and market supply of tobacco in the United States is regulated by a self-sustaining price support system that assigns market quotas for each tobacco producer. Agricultural Adjustment Act of 1938, 7 U.S.C. §§ 1281-1407; 7 C.F.R. Part 723 (1996)[footnote omitted]. Dealers and warehousemen are required to segregate tobacco received from different producers. 7 C.F.R. § 726.85 (1987). Tobacco from one producer that is commingled with tobacco from another producer is considered "falsely identified," 7 C.F.R. § 726.51(k) (1987), and if sold as the tobacco of another producer constitutes the "marketing of excess tobacco." To maintain the viability of the

²(...continued)

the contemplation of § 523(a)(7); penalties also posed no double jeopardy risk since they were civil and remedial rather than punitive in the criminal sense). See also James E. Lockhart, Annotation, *Debts Arising From Penalties as Exceptions to Bankruptcy Discharge Under §§ 523(a)(7), (13) and 1328(a) of the Bankruptcy Code of 1978*, 150 ALR FED. 159, 390-422 (1998).

price support system, excess tobacco is subject to an over-quota marketing penalty of 75% of the tobacco's average fair market value for the prior year. 7 C.F.R. § 726.88(f) (1987). A person, dealer, or warehouse, who acquires over-quota tobacco from a producer must remit the penalty to the government, but may deduct the amount of the penalty from the price paid to the producer. 7 U.S.C. § 1314(a).

In re Martin, 95 F.3d at 407.

With this background, the court turns to the first requirement of § 523(a)(7), that the debt be a "fine, penalty, or forfeiture." Unfortunately, neither the Bankruptcy Code nor the legislative history to § 523(a)(7) defines these terms. See *Matter of Kent*, 190 B.R. 196, 202 (Bankr. D.N.J. 1995)(noting absence of definition in Code). The United States Supreme Court has instructed that "in construing the Bankruptcy Code, 'courts properly assume, absent sufficient indication to the contrary, that Congress intends the words in its enactments to carry their ordinary, contemporary, common meaning.'" *Kentucky v. Seals*, 161 B.R. 615, 618 (W.D. Va. 1993)(quoting *Pioneer Inv. Serv. Co. v. Brunswick Assocs. Ltd. Partnership*, 507 U.S. 380, 388 (1993)). The statute under which the debtor's obligation was assessed characterizes the debt as a "penalty." See 7 U.S.C. § 1314(a). The Sixth Circuit in *Martin* referred to the debtor's obligation as a penalty more than a dozen times. Furthermore, in the only reported decision on point, the bankruptcy court for

the Middle District of Tennessee concluded that the excess tobacco penalty under 7 U.S.C. § 1314(a) was a penalty within the meaning of § 523(a)(7). See *U.S. v. Hite (In re Hite)*, 53 B.R. 21, 23 (Bankr. M.D. Tenn. 1985). As the Sixth Circuit has noted in another § 523(a) dischargeability context, "if something looks like a duck, walks like a duck, and quacks like a duck, then it is probably a duck." *Sorah v. Sorah (In re Sorah)*, 163 F.3d 397, 401 (6th Cir. 1998)(addressing § 523(a)(5) issue). Here, the statute in question not only utilizes the word "penalty," it also operates as such in that it imposes a monetary charge—in common parlance, a penalty—for violating federal law, i.e., marketing tobacco in excess of the quota. As such, the debtor's obligation to the United States is a "penalty" within the meaning of § 523(a)(7).

Before leaving this subject, the court will note that many courts which have separately analyzed the "fine, penalty, forfeiture" component of § 523(a)(7) have concluded that the words convey a punitive or penal connotation. See, e.g., *Virginia v. Collins (In re Collins)*, 173 F.3d 924, 932 (4th Cir. 1999)("a sanction must be penal to be exempt from discharge under § 523(a)(7)"); *In re Nam*, 254 B.R. 834, 840 (E.D. Penn. 2000)("§ 523(a)(7) applies only to penal sanctions that result from the debtor's wrongdoing"); *Tennessee v. Clayton (In re*

Clayton), 199 B.R. 29, 33-34 (Bankr. W.D. Tenn. 1996)(statutory fees imposed as a precondition to reinstatement of driver's license were "penal sanctions for wrongdoing" and thus, "penalties"). See also *Kelly v. Robinson*, 479 U.S. 36, 51 (1986)("On its face, [§ 523(a)(7)] creates a broad exception for all penal sanctions."). In the Sixth Circuit at least, it is highly questionable in light of the *WRW Corp.* decision whether a debt must contain a punitive component in order to be nondischargeable under § 523(a)(7), the Sixth Circuit Court of Appeals having concluded in *WRW Corp.* that a debt may be excepted from discharge under § 523(a)(7) even though it is remedial rather than punitive in nature.³

³The *WRW Corp.* decision appears to be a reflection of the low double jeopardy threshold mandated at the time by the United States Supreme Court, rather than a determination that the penalty at issue had no punitive purpose whatsoever. When *WRW Corp.* was decided by the Sixth Circuit, the controlling authority on the issue of whether a civil penalty constituted punishment for double jeopardy purposes was *U.S. v. Halper*, 490 U.S. 435 (1989). Under *Halper*, unless the sanction solely served the remedial purpose of compensating the government for its loss, it was considered punishment in violation of the double jeopardy clause. See *Hudson v. U.S.*, 522 U.S. at 101 (citing *Halper*, 490 U.S. at 448-49). Since the *WRW Corp.* decision, the Supreme Court has revisited the double jeopardy issue, concluding that *Halper* was an "ill-considered" deviation from longstanding double jeopardy principles. *Hudson*, 522 U.S. at 101. The Supreme Court observed that "[i]f a sanction must be 'solely' remedial (*i.e.*, entirely nondeterrent) to avoid implicating the Double Jeopardy Clause, then no civil penalties are beyond the scope of the Clause." *Id.* at 102. Accordingly, (continued...)

In its most recent pronouncement on the double jeopardy issue, the Supreme Court recognized that "all civil penalties have some deterrent effect," with deterrence being one of the traditional goals of punishment, along with retribution. *Hudson*, 522 U.S. at 101-02. This deterrence factor was the basis for the bankruptcy court's decision in *Hite* that the excess tobacco penalty imposed by 7 U.S.C. § 1314(a) was in fact a penalty within the meaning of § 523(a)(7). *In re Hite*, 53 B.R. at 23. The *Hite* court quoted a Fourth Circuit Court of Appeals decision which had noted that "the congressional intent of the statute was 'to prevent the marketing of excess amounts of tobacco. The penalty is intended as a deterrent against overproduction.'" *Id.* (quoting *U.S. v. Whittle*, 287 F.2d 638, 640 (4th Cir. 1961)). To the extent that the excess tobacco penalty must have a punitive purpose to fall within § 523(a)(7), that purpose is satisfied by the deterrence factor. *SEC v. Telsey (In re*

³(...continued)
the Court disavowed *Halper* and reaffirmed the rule previously established in *U.S. v. Ward*, 448 U.S. 242 (1980). *Id.* at 96. Under *Ward*, the court must determine whether the statutory scheme was so punitive either in purpose or effect as to transform what was clearly intended as a civil remedy into a criminal penalty. *Id.* at 99. Various factors were listed in order to help courts make this determination, with the admonishment that only the clearest proof will suffice to override legislative intent and transform what has been denominated a civil remedy into a criminal penalty. *Id.* at 100.

Telsey), 144 B.R. 563, 565 (Bankr. S.D. Fla. 1992) ("the slightest penal purpose ... will justify characterizing the debt as a 'fine, penalty, or forfeiture' within the meaning of § 523(a)(7).").⁴

The second requirement of § 523(a)(7), that the debt be "payable to and for the benefit of a governmental unit" is easily satisfied in this case. The term "governmental unit" is defined in the Bankruptcy Code to mean "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States" See 11 U.S.C. § 101(27). The debtor has stipulated that the issue in this case is "whether the debt owed by the [sic] Glenn S. Martin to the United States of America is dischargeable under Bankruptcy Code § 523" and there has been no suggestion by

⁴The argument could be made that the Sixth Circuit impliedly recognized the punitive component of the assessment against the debtor by noting that the debtor's criminal conviction and the government's over-quota marketing claim "relate to different misconduct;" thus, inferring wrongdoing on the part of the debtor. See *In re Martin*, 95 F.3d at 408. The fact that the governing statute permits this penalty to be assessed against the buyer, but allows the buyer to recover the penalty from the original tobacco producer, indicates that the over-quota marketing itself triggers the penalty rather than the criminal culpability on the part of any person. See 7 U.S.C. § 1314(a). As the *WRW Corp.* decision illustrates, while this absence of scienter requirement is indicative of a civil remedy rather than a criminal punishment, see *WRW Corp.*, 986 F.2d at 141; it does not preclude a determination of nondischargeability.

the debtor that the obligation in question is payable to or for the benefit of any entity other than a governmental unit. Accordingly, the second required element of § 523(a)(7) has been met.

The last requirement of § 523(a)(7), that the debt not be compensation for actual pecuniary loss, has been alluded to previously in connection with the first requirement, that the debt be a penalty. Because the Sixth Circuit has concluded that the tobacco penalty was "reasonably proportional to the effect of the sale of over-quota tobacco on the price support system," *In re Martin*, 95 F.3d at 408; the debtor asserts that the penalty assessed against him is "compensation for actual pecuniary loss." However, the fact that the penalty is designed in some respect to remedy the loss occasioned by the debtor's wrongdoing does not correlate to "actual pecuniary loss." As previously noted, the civil penalty at issue in *WRW Corp.* was "rationally related to the goal of making the Government whole by roughly compensating it for prosecutorial and investigative expenses." *WRW Corp.*, 986 F.2d at 145. Nonetheless, because the penalty had not been calculated according to "proof of actual pecuniary loss," the Sixth Circuit concluded that it fell within the parameters of § 523(a)(7). Other courts considering the issue have agreed. *See, e.g., Kish v. Farmer (In re Kish)*,

238 B.R. 271, 285 (Bankr. D.N.J. 1999) ("The term 'actual pecuniary loss' clearly connotes measurable damages from particular instances of wrongdoing."). Cf. *U.S. v. Stelweck (In re Stelweck)*, 86 B.R. 833 (Bankr. E.D. Pa. 1988), *aff'd on other grounds*, 108 B.R. 488 (E.D. Pa. 1989) (court held that civil fine imposed under federal False Claims Act (31 U.S.C. § 3729) was compensation for actual pecuniary loss where legislative history stated that fine's purpose was to compensate government for its loss).

In the present case, it is clear from the record submitted by the parties that no evidence of actual damages incurred by the United States was presented to the district court. To the contrary, there is no indication that the United States has actually sustained any damages, other than the cost of its enforcement action. Rather, the penalty assessed against the debtor is based solely on a statutory formula. Even though the penalty may have been designed to approximate "the effect of sale of over-quota tobacco on the price support system," it was not compensation for actual pecuniary loss within the meaning of § 523(a)(7). Accordingly, the third requirement of § 523(a)(7) has been satisfied.

III.

Having determined that the debt at issue is nondischargeable under 11 U.S.C. § 523(a)(7), the court will enter an order contemporaneously with the filing of this memorandum opinion denying the debtor's motion for summary judgment and granting the United States' summary judgment motion.

FILED: March 30, 2001

BY THE COURT

MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE