No. 10-10-796 DEC 13 2010

In The
Supreme Court of the United States

STATE COMPENSATION INSURANCE FUND,

Petitioner,

v.

NANCY ZAMORA, Chapter 7 Trustee,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In *Kelly v. Robinson*, 479 U.S. 36 (1986), this Court held that criminal restitution ordered under state law is not dischargeable in a Chapter 7 bankruptcy because discharging the restitution obligation would violate the policy against federal interference with the state's interest in unfettered administration of its criminal justice system. *Kelly*, however, left unresolved the following related questions:

1. Whether the policy against federal interference with state criminal prosecutions similarly precludes a finding that state criminal restitution payments can be preferences under 11 U.S.C. § 547(b); and

2. Whether criminal restitution, which is ordered to further the state's goals of deterrence and rehabilitation, is "to or for the benefit of a creditor" under 11 U.S.C. § 547(b).

PARTIES AND RULE 29.6 STATEMENT

All parties are listed in the caption.

Petitioner and defendant below, State Compensation Insurance Fund, is a division of the California Department of Industrial Relations and is an agency of the State of California. Cal. Const. art. XIV, § 4; Cal. Lab. Code § 56 (West 2003). No parent corporation or publicly held corporation owns State Fund.

Respondent and plaintiff below, is individual Nancy Zamora, the Chapter 7 Trustee for the estate of Jeffrey L. Silverman and Faye J. Silverman.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner State Compensation Insurance Fund respectfully seeks a writ of certiorari to review the published decision of the United States Court of Appeals for the Ninth Circuit in this case. The Ninth Circuit announced its decision on August 12, 2010. The Ninth Circuit denied rehearing on September 14, 2010.

OPINIONS BELOW

The unpublished decision of the United States Bankruptcy Court for the Central District of California is reprinted in the appendix. (Pet. App. 26.) The unpublished decision of the United States District Court, Central District of California is reprinted in the appendix. (Pet. App. 22.) The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 616 F.3d 1001 and is reprinted in the appendix. (Pet. App. 1.) The unpublished order of the court of appeals denying rehearing is reprinted in the appendix. (Pet. App. 42.)

JURISDICTION

The court of appeals' opinion and judgment was entered on August 12, 2010. A timely petition for rehearing was denied on September 14, 2010. The

jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. § 547(b) provides that a Trustee may recover the transfer of "an interest of the debtor in property" that is:

> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made –
>
> (A) on or within 90 days before the filing of the petition; or
>
> (5) that enables such creditor to receive more than such creditor would receive if –
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (2004).

STATEMENT

A. Jurisdiction in the First Instance.

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 147 and 1334 and 11 U.S.C. §§ 323, 541, 547, 550, and 551. The jurisdiction of the federal district court was invoked under 28 U.S.C. § 158(a) and 28 U.S.C. § 1291, based on its capacity to hear an appeal from the final judgment of a bankruptcy court.

B. Summary of Proceedings.

This petition arises from an adversary proceeding brought by Chapter 7 Trustee Zamora (Trustee) against defendant State Compensation Insurance Fund (State Fund) to avoid and recover as a preference a $101,531.00 criminal restitution payment made by debtor Jeffrey Silverman to the Los Angeles County District Attorney and then forwarded to the victim, State Fund. The bankruptcy court granted the Trustee's motion for summary judgment, finding that the restitution payment fell within the scope of the preference statute.

The district court affirmed the bankruptcy court's order and judgment. The Ninth Circuit affirmed, concluding that the preference statute applied to criminal restitution.

The Ninth Circuit then denied rehearing.

C. Factual and Procedural History.

1. The restitution award and completion of Mr. Silverman's probation.

State Fund provided a policy of workers' compensation insurance to Jeffrey and Faye Silverman for their contracting company. (Pet. App. 2.) On January 14, 2005, the Silvermans were indicted for insurance fraud under California Insurance Code section 11880(a). (Pet. App. 3.) They entered into a plea agreement and Mr. Silverman's sentence included probation, community service, and payment of $101,531.00 restitution to State Fund as the victim of the crime. (Pet. App. 30-31.) The amount of the restitution payment was determined by the criminal court upon a recommendation by law enforcement based on an estimate from State Fund of the appropriate amount of premium owed by the Silvermans absent the fraud. (Pet. App. 30.)

On March 18, 2005, the District Attorney's office sent a check to State Fund in the amount of $101,531.00. The accompanying letter indicated it was payment for the court-ordered restitution in the criminal proceeding.

On April 29, 2005, the Silvermans filed a petition for Chapter 7 bankruptcy. (Pet. App. 3.) Plaintiff Nancy Zamora was appointed Trustee. (Pet. App. 3.)

In December 2006, Mr. Silverman's probation was terminated on a finding that he had complied with the terms of the probation, including making

the $101,153.00 restitution payment to State Fund as the victim of the crime. Upon completion of the conditions of probation, the court released Mr. Silverman from all penalties and disabilities resulting from the offense (with the exception of certain disclosure requirements and a prohibition against owning firearms) and the case was closed. Because the criminal case is closed, the District Attorney has represented that he would not be able to recover the $101,153.00 in restitution if the Trustee takes back the money as a preference.

2. The adversary action against State Fund.

On April 5, 2007, after the criminal case was dismissed, the Trustee filed an adversary proceeding against State Fund to avoid and recover the restitution payment. (Pet. App. 3.) Both parties filed motions for summary judgment to determine whether the restitution payment qualified as a preference under 11 U.S.C. § 547(b). (Pet. App. 4.) The bankruptcy court denied State Fund's motion for summary judgment and granted the Trustee's motion. (Pet. App. 25, 27.) The bankruptcy court determined that criminal restitution was a "debt" under the bankruptcy statutes and was made "to or for the benefit of a creditor" for purposes of the preference statute. (Pet. App. 31-40.) The order was stayed pending appeal.

In an August 12, 2008 minute order, the district court affirmed the bankruptcy court's order. (Pet. App. 22-23.) The district court found that the plain

language of 11 U.S.C. § 547(b) and the weight of authority supported the bankruptcy court's conclusion that the restitution payment was an avoidable preferential payment. (Pet. App. 23.)

3. The Ninth Circuit opinion.

On August 12, 2010, the Ninth Circuit affirmed the district court's order. (Pet. App. 21.) Characterizing the issue as a "novel" one, the Ninth Circuit found the preference statute, 11 U.S.C. § 547(b), does not except criminal restitution payments. (Pet. App. 2.) The court noted that the statute's plain language does not contain such an exception (Pet. App. 10) and that the policy of avoiding federal interference with state criminal proceedings underlying this Court's finding in *Kelly v. Robinson*, 479 U.S. 36 (1986) was not implicated under 11 U.S.C. § 547(b). (Pet. App. 11-15.) According to the court, since the restitution obligation was not dischargeable, the avoidance of the restitution payment as a preference would not eliminate Mr. Silverman's obligation to pay the money to State Fund. (Pet. App. 13.)

The court further held that the restitution payment met the requirements of 11 U.S.C. § 547(b), including the requirement that the payment be "'to or for the benefit of a creditor.'" (Pet. App. 15-20.) The court acknowledged that the purpose of restitution is to further the state's sentencing goals of rehabilitation and deterrence. (Pet. App. 16.) However,

the court nevertheless concluded that the restitution payment was also "'to or for the benefit of a creditor'" because it accomplished the state's sentencing goals by compensating the victim for some, if not all, of the victim's loss. (*Id.*) Thus, the court concluded that even though the restitution benefitted society as a whole, it also benefitted State Fund. (*Id.*)

REASONS FOR GRANTING THE PETITION

Certiorari should be granted because this case presents an important question of federalism left unresolved by this Court's *Kelly* opinion. *Kelly* held that criminal restitution was not dischargeable in a Chapter 7 bankruptcy. In reaching that decision, this Court recognized the importance of a state's interest in administering its criminal laws without federal interference and held that this interest was one of the most powerful considerations influencing the interpretation of Bankruptcy Code provisions. *Kelly*, 479 U.S. at 49.

This Court has yet to speak on a related question – whether a criminal restitution payment can be avoided by the Chapter 7 Trustee as a preference. As demonstrated below, that question involves similar federalism concerns and whether those concerns take precedence over the desire of bankruptcy Trustees to obtain as much money as possible for the debtor's estate to distribute to civil creditors. Because criminal restitution is a common penalty imposed

in criminal cases, the issue is one of widespread importance and should be resolved by this Court. *See* Cal. Penal Code § 1202.4(a)(3) (West 2003) (requiring mandatory restitution in most cases in which victim incurs an economic loss as a result of the crime).

As this Court explained in *Kelly*, criminal restitution is made for the benefit of the state, and is not assessed "'for . . . compensation' of the victim." *Kelly*, 479 U.S. at 53. Although criminal restitution is paid to the victim, it is ordered to rehabilitate the criminal defendant and deter future criminal conduct. *Kelly,* at 49, n.10 ("[r]estitution is an effective rehabilitative penalty because it forces the defendant to confront, in concrete terms, the harm his actions have caused. . . . Similarly, the direct relation between the harm and the punishment gives restitution a more precise deterrent effect than a traditional fine"). However, those goals are thwarted when the restitution that the criminal defendant has already paid to the victim is returned to his estate for the benefit of creditors, as it is unlikely the criminal defendant will ever repay the restitution once it is avoided as a preference.

Indeed, in this case, it appears Mr. Silverman may *not* be required to repay the restitution obligation. After paying the restitution to State Fund, his conviction was expunged, and the expungement order released him from "all penalties and disabilities" (which would presumably include the restitution obligation) flowing from the conviction. Thus, if his restitution payment is now avoided as a preference, he will have been able to recoup and re-allocate that

payment for the benefit of his civil creditors and then may never have to satisfy his obligation to make restitution.

But even in cases in which the restitution payment theoretically could be recovered, it is unlikely to happen as a practical matter. Because the Bankruptcy Code requires all claims (even tardily-filed unsecured claims) to be satisfied before non-dischargeable penalty claims in bankruptcy can be paid, it is unlikely that there would be sufficient funds in the bankruptcy estate to satisfy the restitution obligation. *See* 11 U.S.C. § 726(a)(4), (b) (2004). Nor is it likely that a criminal defendant will have funds to pay restitution after the bankruptcy estate is distributed and the bankruptcy proceedings are concluded. And while the victim can try to chase down the criminal defendant post-bankruptcy, if the criminal case has been closed (as in this case), there is no enforcement machinery in the criminal system, such as revocation of probation, to ensure payment of the obligation. Instead, the obligation takes on the character of a civil judgment, with the victim left to shoulder the burden of ensuring the goals of deterrence and rehabilitation, and a criminal defendant who no longer has the incentive to pay the obligation. Cal. Penal Code § 1202.4(a)(3) (West 2003) (criminal restitution shall be enforceable "as if the order were a civil judgment").

Not only does treating criminal restitution as a preference interfere with the enforcement of penal sanctions, it also interferes with the state's goals of rehabilitation. To encourage rehabilitation of criminal

defendants, California allows a criminal record to be expunged if the criminal defendant serves all the terms of his probation – including making any restitution payment – before probation is complete. However, if a criminal restitution payment is avoided as a preference before the end of probation (unlike this case in which the Trustee has attempted to avoid the payment after the probation was completed), the record likely will not be expunged because the restitution payment has not been made. Thus, the actions of the federal bankruptcy court may deprive the criminal defendant of the opportunity to clear his or her record, thereby interfering with the state's rehabilitation goal.

Since treating criminal restitution as a preference will interfere with state criminal proceedings, the preference statute, 11 U.S.C. § 547(b), should be construed with that effect in mind. Under that provision, one requirement for avoiding payments made by the debtor during the preference period is that the payments were made "to or for the benefit of a creditor." 11 U.S.C. § 547(b) (2004). As discussed, *Kelly* found that criminal restitution is made for the benefit of the state to further its rehabilitation and deterrence goals, not for the benefit of the victim. Accordingly, when the language of the statute is narrowly construed to avoid federal interference in state criminal matters – as it must be – criminal restitution is not made "to or for the benefit of a creditor" and does not fall within the scope of 11 U.S.C. § 547(b).

CERTIORARI SHOULD BE GRANTED TO RESOLVE THE QUESTION WHETHER CRIMINAL RESTITUTION IS A PREFERENCE UNDER 11 U.S.C. § 547.

A. Treating criminal restitution as a preference would interfere with state criminal proceedings.

11 U.S.C. § 547(b) treats a bankrupt debtor's estate as having been established ninety days prior to the debtor's filing of bankruptcy. *See County of Sacramento v. Hackney* (*In re Hackney*), 93 B.R. 213, 218 (Bankr. N.D. Cal. 1988). The statute allows creditors to recover certain payments made by the debtor during this ninety-day preference period. *Id.* The issue in this case is whether a criminal restitution payment made during the ninety-day preference period can be avoided under 11 U.S.C. § 547(b).

In *Kelly,* this Court addressed a similar question, and held criminal restitution was not dischargeable in a Chapter 7 bankruptcy for two reasons: (1) historically, criminal restitution was not dischargeable, despite clear statutory language in prior versions of the Bankruptcy Act suggesting the obligation should be discharged, *Kelly,* 479 U.S. at 40-47; and (2) the fundamental policy against federal interference with state criminal prosecutions required that a restitution obligation not be discharged. *Id.* at 47-50.

As to the second reason, this Court explained that principles of federalism should be applied in construing Bankruptcy Code provisions, and that the

state's interest in freedom from interference in criminal prosecutions is "one of the most powerful of the considerations that should influence a court considering equitable types of relief." *Id.* at 49. Since "[t]he right to formulate and enforce penal sanctions is an important aspect of the sovereignty retained by the States," discharging a restitution obligation would interfere with the state's interest in enforcing its penal sanctions. *Id.* at 47. Such interference, "in turn, would hamper the flexibility of state criminal judges in choosing the combination of imprisonment, fines, and restitution most likely to further the rehabilitative and deterrent goals of state criminal justice systems." *Id.* at 49.

The same analysis applies to the question whether criminal restitution payments can be avoided as preferences. First, as to historical precedent, there is a long history of construing the Bankruptcy Code in a manner that avoids interference with the state's interest in its criminal justice system. *Id.* at 44-45.

Second, just as making criminal restitution dischargeable in bankruptcy would interfere with the state's criminal justice system, so would allowing the Trustee to avoid restitution payments that have already been made. For one thing, avoiding criminal restitution payments interferes with the state's goal of enforcing its penal sanctions. Although, as the court of appeals found, the restitution obligation is not dischargeable in bankruptcy (Pet. App. 13), it may no longer be recoverable in some instances under state law if it is avoided as a preference. For instance,

under California Penal Code section 1203.4, when a defendant has fulfilled the conditions of probation, the defendant's criminal conviction can be expunged, his or her plea can be changed to one of not guilty, and "he or she shall thereafter be *released from all penalties and disabilities* resulting from the offense of which he or she has been convicted. . . ." Cal. Penal Code § 1203.4 (West 2004) (emphasis added). The term "penalties and disabilities" is broadly construed and refers to all criminal penalties and disabilities associated with the sentence, or anything akin thereto. *Kelly v. Mun. Court,* 160 Cal. App. 2d 38, 42 (1958). Thus, if the criminal defendant makes his restitution payment and his record is expunged before the restitution payment is avoided by the bankruptcy court, then the order expunging the conviction may very well preclude any efforts at enforcing the restitution obligation.

Indeed, that is the situation in this case. Before the Trustee filed this adversary action against State Fund, Mr. Silverman completed the terms of his probation, including the payment of restitution to State Fund. Consequently, the criminal action against him was dismissed and he was released from all "penalties and disabilities" resulting from the conviction. If the preference statute applies in this circumstance, Mr. Silverman will be able to re-allocate the restitution payment to the bankruptcy estate in order to pay civil creditors, and may not then have to repay the restitution because, under the expungement order, he has been released from all "penalties and

disabilities" resulting from the conviction. The possibility that he ultimately may not have to pay the restitution unquestionably interferes with the state's interest in enforcing its penal sanctions.[1]

Moreover, even setting aside the effect of California Penal Code section 1203.4, restitution, if avoidable as a preference, will likely remain unpaid in many instances despite being non-dischargeable in bankruptcy. Since criminal restitution is a non-dischargeable penalty, under the Bankruptcy Code, all other claims (including tardily-filed unsecured claims) will be paid from the debtor's estate before any funds would be available to pay restitution. *Findley v. State Bar of Cal. (In re Findley)*, 387 B.R. 260, 268-69 (B.A.P. 9th Cir. 2008); 11 U.S.C. § 726(a)(4), (b) (2004). Thus, it is unlikely that restitution will be paid during the bankruptcy, and instead, would have to be paid after the bankruptcy is discharged. However, once the bankruptcy is discharged, there is no assurance there will be any funds available or the criminal defendant will have the same motivation to

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[1] In its opinion, the court of appeals stated: "[T]he Silvermans served their probation and are left with the criminal record. We cannot see, therefore, how application of § 547(b) to State Fund will compromise or dilute the Silvermans' state sentence (other than, of course, to potentially prolong the time when the Silvermans will fully satisfy their debt to State Fund)." (Pet. App. 14.) As explained, the application of the preference statute does potentially dilute the Silvermans' sentence because the Silvermans may not have to pay the restitution if it is avoided under the preference statute.

pay the restitution obligation. That is particularly true in this case since the criminal case was closed after the Silvermans served their probation. Without the threat of incarceration or revocation of probation for failure to pay the restitution, the likelihood that it will be paid is diminished. *See Zajder v. Hills Dep't Store* (*In re Zajder*), 154 B.R. 885, 888 (Bankr. W.D. Pa. 1993) ("there is no assurance that any funds will be paid. This debtor acknowledges that a portion of the criminal court order is not dischargeable but in fact, to this late date, has not seen fit to comply with even this criminal sanction. With the substantial passage of time, the overcrowded conditions of prison, and the fact that few criminal defendants are incarcerated for failure to pay money, it is not certain that any funds will be paid"). If a criminal defendant avoids his restitution obligation because he is no longer on probation, the goals of the sentencing scheme are undermined and the ability of state criminal judges to fashion the most effective punishment is hampered.[2] *Troff v. State of Utah*, 488 F.3d 1237, 1242-43 (10th Cir. 2007).

Avoiding restitution payments as preferences interferes with criminal proceedings in other ways.

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[2] Even assuming California Penal Code section 1203.4 does not preclude enforcement by a victim, leaving enforcement in the hands of the victim, who may not have the resources or motivation to collect on the restitution order, is not an effective means of furthering the state's goals of rehabilitation and deterrence.

First, if (unlike this case) the Trustee avoided a restitution payment *before* the end of the criminal defendant's probation, the criminal defendant would be denied the opportunity to have his or her record expunged under California Penal Code section 1203.4. The purpose of section 1203.4 is to encourage rehabilitation of criminals; the expungement is "in essence, a form of legislatively authorized certification of complete rehabilitation based on a prescribed showing of exemplary conduct during the entire period of probation." *People v. Covington*, 82 Cal. App. 4th 1263, 1270 (2000). A record cannot be expunged, however, if court-ordered restitution is not paid in full during the probationary period. *Id.* Thus, if a criminal defendant's payment during his or her probation is avoided as a preference, he or she will not be able to pay the restitution in full during the probationary period, despite a willingness to do so, in order to have his or her criminal record expunged.

Second, to avoid equal protection concerns and to give indigent defendants the opportunity to have their criminal records expunged, California Penal Code section 1203.2 allows the court to order restitution based on the defendant's "ability to pay." *Covington,* 82 Cal. App. 4th at 858. However, the possibility that criminal restitution payments can be avoided as a preference complicates the criminal judge's determination of the appropriate amount of restitution under the "ability to pay" provision. In determining the amount of restitution, the court will have to consider not only the defendant's ability to pay, but the

likelihood that the defendant will declare bankruptcy, and whether the Trustee would attempt to avoid restitution payments made during the preference period. Consequently, treating restitution payments as a preference "would hamper the flexibility of state criminal judges in choosing the combination of imprisonment, fines, and restitution most likely to further the rehabilitative and deterrent goals of state criminal justice systems." *Kelly,* 479 U.S. at 49.

Finally, applying the preference statute to criminal restitution would burden state officials and victims. In *Kelly,* this Court found that requiring state officials to object to discharge of a restitution order in the bankruptcy proceeding (as opposed to making the restitution automatically non-dischargeable) would impose burdens and uncertainty on state officials, and that it would be unseemly to require state prosecutors to submit the judgments of their criminal courts to federal bankruptcy courts. *Id.* at 48. Similarly here, it would be burdensome and unseemly to require state officials (who typically first take possession of the restitution payment) or the victim to be the subject of an adversary action to recover restitution as a preference. As the court in *Becker v. County of Santa Clara* (*In re Nelson*) explained:

> If anything, avoidance of restitution obligations is seemingly more intrusive and disruptive of the state's criminal justice system than discharge of restitution. Far beyond merely extinguishing a debt that *ought* to be paid in the future, the trustee seeks to

> recover restitution that *has* been paid; plaintiff attempts to reach into the coffers of the county that convicted the debtor of her crime, and even into the pockets of the individual victim of her theft. Plaintiff's claim would thus turn the state's criminal justice system on its head in a federal bankruptcy proceeding: the state and the crime victim are the defendants, the criminal is the complainant. There can be no doubt that such an ironic and unseemly specter would impose undue burdens and uncertainties on the state (not to mention the victim), would lead to federal remission of state criminal judgments, and would hamper the sentencing decisions of state judges.

Becker v. Cnty. of Santa Clara (*In re Nelson*), 91 B.R. 904, 906 (Bankr. N.D. Cal. 1988).

In sum, allowing the Trustee to recover as a preference a criminal restitution payment would interfere with the state's right to enforce its penalties and encourage rehabilitation and would impose burdens and uncertainty on state officials and victims of crimes.

B. The court of appeals' focus on the rights of civil creditors is misplaced.

In finding that the preference statute applied to criminal restitution, the court of appeals focused on the rights of civil creditors. It held that excepting criminal restitution from the application of 11 U.S.C.

§ 547(b) would preclude a more equitable distribution of a bankruptcy estate's assets and would allow a debtor to pay off a non-dischargeable debt during the preference period, potentially leaving the creditors with nothing. (Pet. App. 14-15.)

The concern for creditors should not be relevant to enforcement of criminal sentences. "'The purpose of bankruptcy is to protect those in financial, not moral, difficulty.'" *Gruntz v. Cnty. of Los Angeles,* 202 F.3d 1074, 1085 (9th Cir. 2000). Thus, "[t]he provisions of the bankrupt act have reference alone to civil liabilities, as demands between debtor and creditor, as such, and not to punishments inflicted pro bono publico for crimes committed." *In re Moore,* 111 F. 145, 150 (W.D. Ky. 1901).

In other words, simply because Mr. Silverman's sentence involves the payment of money does not mean that federal courts should be able to interfere with it. It would be unthinkable for a bankruptcy court to delay or suspend a debtor's jail time or revoke a sentence of community service; yet, the court of appeals' decision has the same effect on a sentence of criminal restitution. "[T]here is 'no rationale or justification for severing economic and noneconomic ramifications of the debtor's criminal conduct.'" *Gruntz*, 202 F.3d at 1085-86 (quoting 3 Collier on Bankruptcy 362-48 (15th ed. 1999)). Consequently, when applying the preference statute, the concerns of creditors involving *civil* debts should be subordinated to the state's concerns in administering its *criminal* justice system. *See id.* at 1086 (noting that "in the

case of the automatic stay, Congress has specifically subordinated the goals of economic rehabilitation and equitable distribution of assets to the states' interest in prosecuting criminals"); *Troff v. State of Utah (In re Troff)*, 329 B.R. 85, 91 (Bankr. D. Utah 2005) (noting Senate Judiciary Committee report that purpose of amendment to Bankruptcy Code effectively overruling *Pennsylvania Department of Public Welfare v. Davenport,* 495 U.S. 552 (1990) – which held that criminal restitution obligations are dischargeable debts under chapter 13 – was to "'prevent Federal bankruptcy courts from invalidating the results of State criminal proceedings'").

The purpose of the preference statute is to discourage creditors "'from racing to the courthouse to dismember the debtor during his slide into bankruptcy'" and to "'facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor.'" *Valley Bank v. Vance (In re Vance)*, 721 F.2d 259, 260 (9th Cir. 1983). The preference law also prevents a debtor from intentionally committing a fraud upon his creditors by voluntarily transferring property to another. *Gray v. Fla. State Univ. (In re Dehon, Inc.)*, 327 B.R. 38, 61 (Bankr. D. Mass. 2005).

The purposes behind the preference statute are not served by treating criminal restitution as a preference. A payment of criminal restitution during the preference period is not made in an attempt to defraud civil creditors. It is a *mandatory* requirement that a criminal defendant must satisfy to fulfill his sentence, and his failure to make that payment could

result in the revocation of probation. Nor could there be any attempt by the state, to whom the restitution is initially paid, to obtain an advantage over civil creditors. As discussed, the state imposes restitution obligations to rehabilitate and deter the criminal defendant, not to keep civil creditors from obtaining the defendant's money.

In short, the state's interest in unfettered administration of its criminal justice system must take precedence over the interest of civil creditors in accumulating money in the bankruptcy estate. The court of appeals erred in giving priority to the interests of civil creditors.

C. Criminal restitution is not "to or for the benefit of a creditor."

One of the statutory elements that must be satisfied before the Trustee may recover a payment made by the debtor during the preference period is that the payment was "to or for the benefit of a creditor." 11 U.S.C. § 547(b). Like all other provisions of the Bankruptcy Code, this language should be considered "in light of the history of bankruptcy court deference to criminal judgments and in light of the interests of the States in unfettered administration of their criminal justice systems." *Kelly,* 479 U.S. at 43-44. Because these interests must be considered,

there are some instances in which literal construction is not permissible.[3] *In re Moore,* 111 F. at 148-49.

When viewed in light of the deference due state criminal judgments, criminal restitution is not "to or for the benefit of a creditor." Instead, it is "to or for the benefit of" the state or society. "Once the state has made an independent decision to file criminal charges, the prosecution belongs to the government, not to the complaining witness." *Gruntz,* 202 F.3d at 1086; *see also id.* ("[A]ny criminal prosecution of the debtor is on behalf of all the citizens of the state, not on behalf of the creditor"). Consequently, the penalties imposed on the criminal defendant, including restitution, are similarly for the benefit of society, not the victim.

Indeed, this question was already resolved in *Kelly*. There, this Court found that criminal restitution was not dischargeable under 11 U.S.C. § 523(a)(7), which protects from discharge any debt that is for a "fine, penalty or forfeiture to and for the

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[3] Thus, for instance, as this Court noted in *Kelly*, court decisions interpreting prior versions of the Bankruptcy Code found that criminal restitution was not dischargeable, despite plain language to the contrary. *Kelly,* 479 U.S. at 44-45 ("The most natural construction of the [1978] Act, therefore, would have allowed criminal penalties to be discharged in bankruptcy, even though the government was not entitled to a share of the bankrupt's estate. . . . But the courts did not interpret the Act in this way. Despite the clear statutory language, most courts refused to allow a discharge in bankruptcy to affect the judgment of a state criminal court").

benefit of a governmental unit, and is not compensation for actual pecuniary loss." 11 U.S.C. § 523(a)(7). The Court explained:

> The criminal justice system is not operated primarily for the benefit of victims, but for the benefit of society as a whole. Thus, it is concerned not only with punishing the offender, but also with rehabilitating him. Although restitution does resemble a judgment "for the benefit of" the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of restitution awarded or over the decision to award restitution. Moreover, the decision to impose restitution generally does not turn on the victim's injury, but on the penal goals of the State and the situation of the defendant.

Kelly, 479 U.S. at 52. Thus, this Court concluded, "[b]ecause criminal proceedings focus on the State's interests in rehabilitation and punishment, rather than the victim's desire for compensation, we conclude that restitution orders imposed in such proceedings operate 'for the benefit of' the State. *Similarly, they are not assessed 'for . . . compensation' of the victim.*" *Id.* at 53 (emphasis added).

The court of appeals acknowledged *Kelly*'s holding that restitution furthers the state's sentencing goals. (Pet. App. 16.) However, it held that criminal restitution is also for the benefit of a creditor because it directly compensates the victim for some, if not all, of the victim's loss. (Pet. App. 16.) This conclusion,

however, is directly contrary to this Court's holding that criminal restitution is not assessed "'for . . . compensation' of the victim." *Kelly*, 479 U.S. at 53. The fact that the victim may obtain an incidental benefit from a restitution payment does not mean that the payment was *intended* to benefit the victim.

The court of appeals supported its holding by noting that under California Penal Code provisions, (1) the restitution amount is based on the amount of loss claimed by the victim, (2) the restitution shall be enforceable as if it were a civil judgment, and (3) the restitution is to be paid directly to the victim.[4] (Pet. App. 17-18.) Thus, it concluded that the victim had extensive control over the payment's enforcement, which established the victim's interest in and benefit from the payment. (Pet. App. 17.)

However, these provisions do not show that the *purpose* of the restitution payment was to benefit the victim. In cases involving similar circumstances, courts have held that criminal restitution is not dischargeable under 11 U.S.C. § 523(a)(7) because the restitution is still for the benefit of a governmental unit. *See Colton v. Verola,* 446 F.3d 1206, 1207, 1209 (11th Cir. 2006) (criminal restitution payment that was paid to department of corrections and then

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[4] Although restitution is enforceable in the manner of a civil judgment, there is no actual money judgment; instead, the execution is on the restitution order already entered. *People v. Hart,* 65 Cal. App. 4th 902, 906 (1998).

forwarded to victim was not dischargeable); *Reif v. Kaster (In re Reif)*, 363 B.R. 107, 109-10 (Bankr. D. Ariz. 2007) (criminal restitution payment is non-dischargeable even if it is "ultimately paid to the victim rather than the state and notwithstanding the fact that the restitution amount is equivalent to the victim's loss"); *but see Nat'l Auto Sales, Inc. v. Wilson (In re Wilson)*, 299 B.R. 380, 384 (Bankr. E.D. Va. 2003) (criminal restitution to be paid in an amount determined in a civil trial brought by victim was dischargeable in bankruptcy). Nor does it matter that the restitution could be enforced as a civil judgment. As the Tenth Circuit explained, although the fact that restitution converted to a civil judgment after the debtor served his sentence may alter the consequences of the debtor's non-payment, it does not change the fact that the restitution was part of a criminal sentence. *Troff,* 488 F.3d at 1241 n.1. The same is true here.

In short, none of the factors relied upon by the court of appeals changes the purpose behind the restitution sentence, which is to benefit society, not the victim. Thus, especially when 11 U.S.C. § 547(b) is construed in deference to the state's interest in avoiding federal interference with its criminal justice system, criminal restitution is not paid "to or for the benefit of a creditor." 11 U.S.C. § 547(b). The preference statute does not apply.

CONCLUSION

For all of the foregoing reasons, petitioner respectfully submits that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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