**Section 525(a) and Section 525(b)**

**Limitations on Discrimination Against Debtors**

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Recently, the *New York Times* reported that people who have filed bankruptcy cases have had difficulty getting jobs. A credit check will reveal whether a debtor has filed a bankruptcy case at any time within the past 10 years. And National Pacer will reflect a debtor’s bankruptcy essentially forever. Some employers believe that a bankruptcy filing predicts that a prospective employee may be unreliable. Moreover, laws in some states make it difficult for a former debtor in bankruptcy to get or maintain a professional license.

Sections 525 of the Bankruptcy Code was enacted to protect debtors from discrimination. The benefits of Section 525 are broad but by no means all-encompassing. Section 525(a) is broader than 525(b) and provides protection against government discrimination in the grants of licenses and employment decisions, including the decision to hire.

Section 525 codified the result in *Perez v. Campbell*, 402 U.S. 637 (1971). In *Perez*, the Court held that a state may not suspend the driver's license of a debtor whose tort judgment resulting from an automobile collision was discharged. The Court found that the state financial responsibility statute was in conflict with the "fresh start" policy of the Bankruptcy Act (now the Bankruptcy Code) i*d.* at 652. The Court recognized that the fresh start offered by Bankruptcy would be frustrated by the discriminatory treatment resulting from the unpaid debt arising from a tort claim.

Section 525 is divided into three subsections: subsection (a) which deals with discrimination by government, subsection (b) which deals with discrimination by non-governmental persons and entities, and subsection (c) which addresses student loans. Subsection (c) is beyond the scope of this presentation and won’t be explored here.

The distinctions between subsections (a) and (b) are subtle but important.

Section 525(a) provides:

§ 525. Protection against discriminatory treatment

1. Except as provided in the Perishable Agricultural Commodities Act, 1930, the Packers and Stockyards Act, 1921, and section 1 of the Act entitled “An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes,” approved July 12, 1943, a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

Subsection 525(b) provides:

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

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

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

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

***Limitations on Governmental Discrimination in Licensing and Employment***

Recognizing that Section 525 and its predecessor statute under the Bankruptcy Act was the codification of *Perez v. Campbell, supra,* it is appropriate to consider the impact of Section 525(a) on governmental licensing first.

Recently the Northern District of Illinois analyzed the licensing provisions of §525(a). *Slayton v. White (In re Slayton),* Adv. Pro 09-A- 100; 06 B 2826 (N.D. Ill. 2009).[[1]](#footnote-1) In this case the debtors had owned and operated a trucking business through a corporation. The corporation had filed a chapter 11 bankruptcy case which was promptly tanked when the bank obtained relief from the stay. The Bank set off against the corporation’s bank accounts. As a result, the corporation’s checks to the Illinois Secretary of State for license plates for its trucks bounced. To add insult to injury, the trucks were also repossessed and the license plates were never used.

Subsequently, Fred and Ann Slayton, former officers of the corporation, husband and wife, one of whom was a signatory for the checks to the Secretary of State for the license plates, filed a joint chapter 7 case. In due course, they received a discharge.

After the discharge the Illinois Secretary of State cancelled the Slaytons’ driver’s licenses because the trucking company’s check to the Secretary of State had bounced. The State of Illinois’ claim was not based on any statute or regulation, but simply a policy. The claim not been scheduled since it had not been even asserted by the State at the time of the Slayton’s filing. The States claims would be discharged under the *Mendiola* doctrine, followed in the Eastern District of Wisconsin[[2]](#footnote-2) The Slaytons filed an adversary proceeding for damages under Section 525(a) and also sought to have the Secretary held in contempt of court for violation of the discharge injunction.

The Secretary moved to dismiss. The court denied the motion to dismiss and held that the Slayton’s complaint for damages stated a claim upon which relief could be based under section 525(a). The court granted the motion to dismiss as to punitive damages. And the court indicated that the proper procedure to follow in order to hold the Secretary of State in contempt would be a motion rather than an adversary proceeding.

In so ruling, the bankruptcy court overruled the Illinois Attorney General’s objections that the bankruptcy court had no jurisdiction over the Secretary. In fact the Attorney General asserted that the bankruptcy court lacked even subject matter jurisdiction citing the Eleventh Amendment to the Constitution

The Secretary relied on recent Supreme Court authority of *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996), and *Nelson v. La Crosse County Dist. Att’y*, 301 F.3d 820 (7th Cir. 2002). However, the bankruptcy court decided that “as the Slaytons rightly point out, however, the Secretary’s reliance on these cases suggests he is a bit behind the times.”

Sovereign immunity can be abrogated in one of three ways:

Traditionally, there have been three exceptions to Eleventh Amendment immunity. First, a state may waive immunity by consenting to be sued in federal court. *Id.* Second, Congress may abrogate the state’s immunity “through a valid exercise of its powers.” *Id.*; *see also Toeller v. Wisconsin Dep’t of Corrections*, 461 F.3d 871, 875 (7th Cir. 2006). And third, under the doctrine of *Ex parte Young*, 209 U.S. 123 (1908), a plaintiff may “file ‘suit[ ] against state officials seeking prospective equitable relief for ongoing violations of federal law.’

*Peirick*, 510 F.3d at 695 (quoting *Marie O. v. Edgar*, 131 F.3d 610, 615 (7th Cir. 1997)).

In section106(a) of the Bankruptcy Code, Congress sought to employ the second of these exceptions, abrogating the sovereign immunity of every “governmental unit” with respect to many sections of the Code, including sections 524 and 525 under which the Slaytons have brought their claims. *See* 11 U.S.C. § 106(a).

Judge Goldgar noted that under *Seminole* and *Nelson,* the Slaytons’ claim likely would be barred.

Two years after *Nelson*, however, the Supreme Court in *Tennessee Student*

*Assistance Corp. v. Hood*, 541 U.S. 440 (2004), addressed Eleventh Amendment immunity in the bankruptcy context and found no bar to a chapter 7 debtor’s adversary proceeding against a state agency seeking the discharge of her student loan obligations as an undue hardship. *Id.* at 444-45. Rather than consider the problem as one of section 106(a) abrogation, the Court held that unconsenting states could be subjected to judicial actions that are *in rem* as opposed to *in* *personam*, *id.* at 446, and that the discharge of a debt in bankruptcy is “an *in rem* proceeding,” *id.* at 447. A debtor seeking only the discharge of a debt, the Court reasoned, does not “subject an unwilling State to a coercive judicial process.” *Id.* at 450. A discharge determination is therefore “not a suit against a State for purposes of the Eleventh Amendment.” *Id.* at 451.

Judge Goldgar went on to carefully analyze the *in rem* jurisdiction of the bankruptcy court as well as the ancillary *in rem* jurisdiction of the Bankruptcy Court addressed by the Supreme Court in *Central Va. Cmty. College v. Katz*, 546 U.S. 356 (2006), which concerned a trustee’s action torecover preferential payments made to state agencies. The Court held that the provision authorizing Congress the exclusive right to regulate bankruptcy in Article I, section 8 of the Constitution was an important part of the Plan of the Convention to avoid a patchwork quilt of insolvency laws around the country. The point of this is that Congress intended states to be amenable to bankruptcy jurisdiction to the extent provided by bankruptcy laws because the jurisdiction of the bankruptcy court is either *in rem* or “ancillary” to *in rem* jurisdiction. [[3]](#footnote-3)

So the bankruptcy court denied the State’s motion to dismiss the Slaytons’ complaint.

The implications of this decision are important. Section 525(a) is a limitation on state authority. It is a limitation under the Bankruptcy Code. The Bankruptcy Code is enacted by Congress pursuant to its constitutional rights under Article I section 8. The right of Congress to limit the State’s authority is not an abrogation of sovereign immunity. Rather it is a part of the Plan of the Convention. The bankruptcy court has *in rem* jurisdiction to enforce the provisions of Section 525(a) as well as jurisdiction ancillary to *in rem*

The Seventh Circuit Court of Appeals has also resolved violations of the antidiscrimination clause of the Bankruptcy code in favor of a debtor with a cancelled license. *Airadigm Communications Inc. v. Federal Communications Commission,* 519 F.3d 640 (7th Cir. 2008).

*In re Adler,* 47 B.R. 554 (Bankr. S.D. Fla. 1985)holds that section 525(a) prohibits enforcement of statute that allows state department of motor vehicles to suspend licenses and registrations of judgment debtors, even if motor-vehicle-related judgments against them were discharged in bankruptcy); ability to engage in a trade or business,

Moreover, *In re Walker,* 927 F.2d 1138 (10th Cir. 1991) found a statute, which automatically revokes real estate license of any licensee for whom payment was made from real estate recovery fund, contravenes section 525(a).

*In re Heath*, 3 B.R. 351 (N.D. Ill. 1980) held that a state university's refusal to release student-debtor's transcript until he paid prepetition debt in full violated section 525(a) as well.

And in *Stoltz v. Brattleboro Housing Authority (In re Stoltz),*310 F.3d 80 (2d Cir. 2002), the Second Circuit held that a person’s continued right to rent public housing constituted a governmental license which could not be denied by reason of section 525(a).

***Employment Issues***

Both sections 525(a) and 525(b) apply to cases involving employment discrimination based discharging a debt in bankruptcy. In order to fully understand the antidiscrimination clause of the Bankruptcy Code, it must be compared to other employment retaliation claims.

A traditional retaliation claim exists to encourage employees to engage in protected activities, such as voting or reporting employer misconduct. The retaliation claim reassures employees that there is recourse if an employer subjects an employee to an adverse employment action because the employee engaged in a protected activity.

The antidiscrimination clause is not intended to encourage an employee to file bankruptcy, but to protect those who have attempted to obtain a fresh start through bankruptcy proceedings. *Majewski v. St. Rose Dominican Hospital,* 310 F. 3d 653 (9th Cir. 2002). At first glance, a claim under section 525 appears to operate as other retaliation claims. However, analyzing the policy behind these claims creates a foundation for the stringent requirements of section 525.

Section 525(a) only applies to government units. Debtors employed in the private sector are limited to claims under section 525(b). Section 525(a) prevents a governmental unit from denying employment to, terminating the employment of, or discriminating with respect to employment against a person that has been a debtor under this title solely because of filing a bankruptcy.

Section 525(b) prevents a private employer from terminating the employment of an individual or discriminating with respect to employment of an individual solely because of filing a bankruptcy.

The majority of jurisdictions hold that these provisions only protect individuals who have actually filed a case. Individuals expressing a desire to file a bankruptcy case in the future are not protected by the majority of jurisdictions. *Kanouse v. Gunster, Yoakley & Stewart,* 168 B.R. 441 (Bankr. S.D. Fl 1994). *Tinker v. Sturgeon State Bank (In re Tinker)*, 99 B.R. 957 (Bankr. W.D. Mo. 1989),is to the contrary but has not been widely followed.

There is also a split in authority regarding whether section 525(b) applies to failure to hire claims. Courts consistently hold that section 525(a) prohibits a governmental unit from refusing to hire an individual solely because debts have been discharged in bankruptcy. A private sector employee utilizing §525(b) cannot be discharged or subjected to discriminatory practice with respect to employment. But the provision included in section 525(a) prohibiting denying employment to a debtor is not included in section 525(b). *In re Madison (Madison International of Illinois),* 77 B.R. 678 (Bankr. E.D. WI 1987). See also [*Pastore v. Medford Sav. Bank,* 186 B.R. 553 (D.Mass.1995)](https://www.fastcase.com/Pages/Document.aspx?LTID=HiuAgcXITvR0jUUZp3fmpZL1R61J7yTSvbEJG9xiq2%2bWoG3Vseg8NSyiJTnEFnjU2EOlJVuyQKtZiqivttofx3HmYD3rHb7CN74C0cJoKplrfu8usQ5g1RWE5S9HJKbR&ECF=Pastore+v.+Medford+Sav.+Bank%2c%3c%2fI%3e+186+B.R.+553+(D.Mass.1995))(holding that section 525(b) does not provide a cause of action of failure to hire); *In re Hardy,* 209 B.R. 371 (Bankr.E.D.Va.1997) (requiring an employment relationship as a prerequisite for the applicability of section 525(b)); *In re Hopkins*, 81 B.R. 49 (Bankr.W.D.Ark.1987) (holding section 525(b) reaches private employers only after an offer of full-time employment has been extended);

This rather narrow construction of a remedial statute has been reached by drawing a negative inference comparing this statute with section 525(a). Section 525(a) states that the government may not "deny employment to, terminate the employment of or discriminate with respect to employment against" a person who has been a bankruptcy debtor. Section 525(b), while similar in language, does not contain the phrase "deny employment to." One cannot infer from this omission not only that it was purposeful to achieve a disparate result where the Government is the employer, but that section 525(b) accordingly allows employers to discriminate on the initial hiring against those unfortunate economic casualties who are seeking or have obtained a fresh start from the bankruptcy court, and yet at the same time prohibits discrimination against those who have been hired.

If the phrase "with respect to employment" covers hiring decisions, then provisions in sections 525(a) and (b) become an exercise in redundancy. *See Casey,* 499 U.S. at 101. Most courts will not ascribe a substantive meaning to the terms "deny employment to" in section 525(a) if "discriminate with respect to employment" is read to encompasses discriminatory hiring. The explicit inclusion of the phrase "deny employment to" in section 525(a), preceding the phrase "discriminate with respect to employment," leads most courts to concluded that Congress believed the phrases offered different protections to a Title 11 debtor. To interpret "discriminate with respect to employment" in § 525(b) to mean that a private employer may not deny employment to a Title 11 debtor would create render subsection (a) superfluous.

From an historical perspective, it is interesting to note *Wilson v. Harris Trust & Savings Bank,* 777 F2d 1246 (7th Cir. 1985). There, the court held that Bankruptcy Code section 525(a) was not applicable to private entitles, noting that section 525(b) had just been enacted and that subsection (b) would not be required if it private discrimination were already prohibited by subsection a. The Seventh Circuit stated “Congress amended sec. 525 in 1984 to provide that the prohibitions in subsection (a) now apply to private, as well as public, employers. See 11 USC sec. 525(b). One wonders whether the Seventh Circuit would read subsection 525(a) and (b) as containing the same prohibitions in light of subsequent judicial decisions interpreting the respective subsections.

***Conclusion***

Section 525(a) affords powerful limitations on the government’s rights to deny employment or licensing rights after a debtor has received a discharge in bankruptcy. Such limitations are an appropriate exercise of federal jurisdiction, both *in rem* and ancillary to *in rem* jurisdiction, and not an abrogation of Sovereign Immunity, all in accordance with the Plan of the Convention.

Moreover, Section 525(a) prohibits denial of employment by governmental bodies on account of an individual’s having received a discharge in bankruptcy. Nevertheless, Section 525(b) of the bankruptcy code has a more limited impact in the private sector. While an existing employee may not suffer discrimination on the job on account of a discharge in bankruptcy, a person may be denied employment by a prospective employer in the private sector solely on account of that person’s having been a debtor in bankruptcy. One wonders whether further Congressional action is required. Or perhaps BAPCPA was, in fact, perfect in every way and provided adequate consumer protection as written.

1. <http://www.ilnb.uscourts.gov/opinions/JudgeGoldgar/Slayton.pdf> [↑](#footnote-ref-1)
2. In re *Guseck,* 310 B.R. 400 (Bankr. E.D. Wis. 2004). [↑](#footnote-ref-2)
3. *See* Ralph Brubaker, *Explaining Katz’s New Bankruptcy Exception to State Sovereign*

   *Immunity: The Bankruptcy Power as a Federal Forum Power*, 15 Am. Bankr. Inst.

   L. Rev. 95, 96 (2007). [↑](#footnote-ref-3)