

2016

No Misrepresentation Needed: Excepting Discharge for Actual Fraud Under 11 U.S.C. § 523 Without Misrepresentation

Morgan Green
Fordham University School of Law

Follow this and additional works at: <https://ir.lawnet.fordham.edu/flr>



Part of the [Bankruptcy Law Commons](#)

Recommended Citation

Morgan Green, *No Misrepresentation Needed: Excepting Discharge for Actual Fraud Under 11 U.S.C. § 523 Without Misrepresentation*, 84 Fordham L. Rev. 2919 (2016).

Available at: <https://ir.lawnet.fordham.edu/flr/vol84/iss6/19>

This Note is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

**NO MISREPRESENTATION NEEDED:
EXCEPTING DISCHARGE FOR ACTUAL FRAUD
UNDER 11 U.S.C. § 523 WITHOUT
MISREPRESENTATION**

*Morgan Green**

Imagine buying a game from a seller and promising to repay him at a later date. However, instead of repayment, you decide to give the game to your friend, who in turn allows you to use it. Then your friend declares bankruptcy to discharge the price of the game from his debts, thus allowing you both to use it without paying. This repayment runaround is the issue that the First and Fifth Circuits were asked to decide in two recent cases. Specifically, the question was whether a debt incurred by “actual fraud” may be discharged by the recipient of the transfer without a misrepresentation of repayment.

The Bankruptcy Code (“the Code”) serves as a vehicle to help those who have encountered unsuccessful ventures to discharge their obligations and start anew. The Code does not, however, grant a debtor the absolute right of discharge, as many exceptions exist to prevent fraudulent behavior. One of these exceptions is 11 U.S.C. § 523(a)(2)(A), which excepts from discharge any debt obtained by “false pretenses, a false representation, or actual fraud.” Circuit courts have differed in their application of the statute, thus creating a circuit split concerning whether a debtor must make a misrepresentation in order to constitute “actual fraud.” This Note argues that “actual fraud” is meant to encompass a fraudulent transferee’s intent to defraud and does not require a misrepresentation concerning the prospect of repayment. By focusing on the transferee’s intent, these debts would be nondischargeable, thus requiring repayment to the seller.

INTRODUCTION.....	2920
I. NOT ON THE SAME PAGE: CIRCUITS DISAGREE ON WHETHER MISREPRESENTATION IS REQUIRED UNDER § 523	2922
A. <i>No Misrepresentation Necessary: The Seventh and First Circuits Require Only Fraudulent Intent</i>	2923

* J.D. Candidate, 2017, Fordham University School of Law; B.A., 2014, University of Michigan. I would like to thank Professor Susan Block-Lieb for her guidance and encouragement throughout the writing process. I also would like to thank my family and friends for their unwavering support.

B. <i>Of Course Misrepresentation Is Required: The Fifth Circuit Will Not Except Debts Under § 523 Without Misrepresentation</i>	2925
II. HOW DID WE GET HERE?: THE DEVELOPMENT OF AMERICAN BANKRUPTCY LAW	2928
A. <i>Bankruptcy: As American As Apple Pie</i>	2928
B. <i>Discharge: How Do Debts Disappear?</i>	2930
III. MISREPRESENT THIS: § 523 DOES NOT REQUIRE MISREPRESENTATION	2933
A. <i>Legislative History and Prior Case Law</i>	2933
1. Legislative History: Attributing Meaning Based on Congressional Intent	2934
2. Case Law: Attributing Meaning Based on the Supreme Court’s Jurisprudence	2936
B. <i>Text: What Did the Terms Mean When the Statute Was Enacted?</i>	2937
C. <i>Aligning § 523 with the Purpose of the Code</i>	2941
D. <i>Modernizing the Statute: Making § 523 Work in the Context of Credit Card Transactions</i>	2942
E. <i>Finding the Correct Balance Between Creditors and Debtors</i>	2942
CONCLUSION	2944

INTRODUCTION

Most believe that people are entitled to a second chance—that one mistake should not permanently affect someone and be held over him or her forever. In many ways, the concept of a second chance was the focal point of the current Bankruptcy Code (“the Code”), which grants a debtor a less encumbered fresh start after bankruptcy. The Code generally allows debtors to discharge their debts and start anew without a large sum hanging over their head.¹ However, there are many exceptions in the Code to ensure that only honest and unfortunate debtors reap these benefits.² One example is 11 U.S.C. § 523(a)(2)(A), which prevents the discharge of a debt “obtained by false pretenses, a false representation, or actual fraud.”³

This provision has caused confusion among the appellate circuits regarding whether a misrepresentation by the debtor is required to constitute “actual fraud” within the meaning of the statute.⁴ A circuit split

1. See 11 U.S.C. § 727 (2012).

2. See S. REP. NO. 95-1106, at 1 (1978).

3. 11 U.S.C. § 523(a)(2)(A).

4. Compare *Husky Int’l Elecs., Inc. v. Ritz* (*In re Ritz*), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145) (holding that a misrepresentation is required to constitute “actual fraud” under the statute), with *Lawson v. Sauer Inc.* (*In re Lawson*), 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (ruling that a misrepresentation is not required to constitute “actual fraud” under the statute).

arose from different holdings in two similar cases, both involving the transfer of an already incurred debt to a third party to avoid repayment to the creditor, and neither of which involved a misrepresentation concerning repayment of the debt.⁵ The contrasting opinions highlight two different theories regarding the scope of the statute with respect to the requirement (or lack thereof) of a debtor's misrepresentation, thus creating a circuit split on the appropriate statutory interpretation.

The Fifth Circuit, which requires a debtor's misrepresentation to constitute actual fraud, allowed a debt to be discharged when the debtor transferred funds to corporate entities that he controlled in order to avoid repayment to the creditor because he did not misrepresent the prospect of repayment.⁶ To determine that Congress intended to require a misrepresentation as a necessary element of actual fraud, the court relied on a Supreme Court opinion addressing a different provision of § 523,⁷ and its interpretation of the definition of "actual fraud" as it was known in 1978—the year the Code was revised.⁸ Additionally, the Fifth Circuit noted that there is a separate provision in the Code that governs fraudulent transfers meant to hinder or defraud a creditor that better fit the facts of the case.⁹

By contrast, the First Circuit, in a case involving a similar set of facts, determined that such a runaround of the creditor—even without a misrepresentation—should not be entitled to the benefits of the Code.¹⁰ In doing so, the court relied on canons of construction, legislative history, and its interpretation of the meaning of "actual fraud" to determine that a misrepresentation is not required under the statute. In expressly disagreeing with the Fifth Circuit,¹¹ the First Circuit held that the statute is meant to recognize the difference between constructive and actual fraud, which concerns the intent of the transferee to defraud and is not intended to require a misrepresentation from the debtor.¹² Both of the losing parties in these cases filed petitions for certiorari to the Supreme Court to resolve the split regarding this issue of statutory interpretation.¹³ On November 6, 2015, the Supreme Court granted the petition in *Husky International*

5. See generally *Ritz*, 787 F.3d 312; *Lawson*, 791 F.3d 214.

6. See *Ritz*, 787 F.3d at 317–18.

7. See *id.* at 317 (citing *Field v. Mans*, 516 U.S. 59, 63 (1995) (holding that a misrepresentation under 11 U.S.C. § 523(a)(2)(A) requires a showing of justifiable reliance)). In *Field*, the Court noted that the terms in the statute are terms of art that take on the common law meaning associated with them when the provision was enacted. *Field*, 516 U.S. at 69. This applies to "actual fraud" as well as "misrepresentation" under § 523. *Id.*

8. See *Ritz*, 787 F.3d at 320.

9. See *id.* (citing 11 U.S.C. § 727(a)(2) (2012)) ("The court shall grant the debtor a discharge, unless . . . the debtor with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor."). This provision affects the transferee of the already-incurred debt, but it does not allow a creditor to reach the recipient of the transfer. *Id.*

10. See *Lawson*, 791 F.3d at 220–21.

11. *Id.* at 216.

12. See *id.* at 220 (citing *McClellan v. Cantrell*, 217 F.3d 890, 894–95 (7th Cir. 2000)).

13. See Petition for Writ of Certiorari, *Husky Int'l Elecs., Inc. v. Ritz* (*In re Ritz*), 2015 WL 4593754 (U.S. July 30, 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145); Petition for Writ of Certiorari, *Lawson v. Sauer Inc.* (*In re Lawson*), 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113).

*Electronics, Inc. v. Ritz*¹⁴ and heard the case in March of 2016.¹⁵ It chose not to act on the petition from *Lawson v. Sauer Inc.*¹⁶ filed in the same year.¹⁷

This Note focuses on the inconsistencies in the application of 11 U.S.C. § 523(a)(2)(A) in requiring a misrepresentation to constitute actual fraud, specifically as it relates to the circuit split that arose from *Ritz* and *Lawson*. Part I discusses the case law construing § 523, including a precursor to the split, as well as the circuit courts' decisions in *Ritz* and *Lawson*. Part II discusses bankruptcy law and explains how the current Code took its form. Specifically, it describes the history of bankruptcy in America as well as discharge—particularly in the context of 11 U.S.C. §§ 523 and 727—and explains its purpose in the Code. Finally, Part III argues that § 523 does not require a misrepresentation to constitute “actual fraud.” A reading of the statute that requires a misrepresentation (1) is contrary to legislative history of the provision and prior case law construing the statute; (2) is contrary to the plain meaning of the text of the statute; (3) is contrary to the purpose of the Code; (4) is inapplicable with respect to modern transactions (e.g., credit card transactions); and (5) fails to adequately balance the rights between creditors and debtors. For these reasons, it is clear that § 523 does not require a misrepresentation to constitute “actual fraud,” and a contrary reading of the statute is severely limiting in instances such as *Ritz* or *Lawson*.

I. NOT ON THE SAME PAGE: CIRCUITS DISAGREE ON WHETHER MISREPRESENTATION IS REQUIRED UNDER § 523

Courts have struggled to interpret § 523, particularly concerning whether a misrepresentation is required to constitute “actual fraud.”¹⁸ While a difference in opinions from seemingly analogous cases during the summer of 2015 highlighted this issue and formally created the circuit split,¹⁹ the divergence began with an earlier case from the Seventh Circuit in 2000.²⁰

14. 136 S. Ct. 445 (2015) (No. 15-145).

15. SUPREME CT. U.S., <http://www.supremecourt.gov/search.aspx?filename=/docketfiles/15-145.htm> (last visited Apr. 29, 2016) (indicating the dates that the petition was granted and the case argued) [<https://perma.cc/QS9X-8EWU>].

16. 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113).

17. SUPREME CT. U.S., <http://www.supremecourt.gov/search.aspx?filename=/docketfiles/15-113.htm> (last visited Apr. 29, 2016) (indicating, as of publication, that the Supreme Court has not granted or denied the petition for certiorari) [<https://perma.cc/9TT2-G2BX>].

18. *Compare* *Husky Int'l Elecs., Inc. v. Ritz* (*In re Ritz*), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (requiring a formal misrepresentation by a debtor in order to constitute “actual fraud” under the statute), *with* *Lawson*, 791 F.3d 214 (rejecting the misrepresentation requirement used by the Fifth Circuit), *and* *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) (holding that misrepresentation is not required under the statute by relying upon canons of construction and legislative history).

19. *See Ritz*, 787 F.3d 312; *Lawson*, 791 F.3d 214.

20. *See McClellan*, 217 F.3d 890.

A. *No Misrepresentation Necessary: The Seventh and First Circuits Require Only Fraudulent Intent*

Before the First and Fifth Circuits disagreed, the Seventh Circuit decided a similar case involving “actual fraud,” which laid the groundwork for the current split.²¹ The specific issue in *McClellan v. Cantrell*,²² like that of *Ritz* and *Lawson*, was whether misrepresentation is a required element of “actual fraud” under § 523.²³

In the case, the creditor, McClellan, sold ice-making machinery to the declarant’s brother who ultimately defaulted on the security interest.²⁴ Shortly after McClellan filed suit against the brother, the brother sold the machinery to his sister, Cantrell, for ten dollars, and she quickly sold it for \$160,000.²⁵ Two years later, Cantrell filed for bankruptcy seeking to discharge the original debt. McClellan objected—seeking to recover the value of the machinery—claiming Cantrell was the recipient of a fraudulent transfer of her brother’s debt under § 523.²⁶ The issue of contention quickly became whether a misrepresentation is required to constitute “actual fraud” under the statute.²⁷ It was clear that Cantrell, who maintained no contact with the creditor, had not made any misrepresentations to him regarding repayment for the machinery.²⁸

The district court evaluated the case under the framework of *Field v. Mans*,²⁹ an earlier Supreme Court case concerning the level of reliance needed from a creditor in regard to a debtor’s misrepresentation under the misrepresentation prong of § 523.³⁰ Using *Field* as a guide, the court ruled that in order for a debt to be nondischargeable under § 523(a)(2)(A), a debtor must make a misrepresentation that the creditor reasonably relied on.³¹ On appeal, the Seventh Circuit reversed the district court’s opinion and ruled that *Field* was not controlling, as the current facts were distinguishable from the prior case.³² The court went on to note that many cases assume that fraud and misrepresentation are intertwined, but most of those cases involve situations that solely concern misrepresentation and not

21. *See id.*

22. 217 F.3d 890 (7th Cir. 2000).

23. *See id.*

24. *Id.* at 892.

25. *Id.* The machinery originally was sold to Cantrell’s brother for \$200,000. *Id.* The \$160,000 that Cantrell received disappeared, and she would not tell the court where it went. *Id.*

26. *Id.*

27. *Id.* at 892–93.

28. *See id.*

29. 516 U.S. 69 (1995).

30. *See* *McClellan v. Cantrell*, No. 99 CV 5601, 1999 WL 966097, at *3 (N.D. Ill. Oct. 13, 1999), *rev’d*, 217 F.3d 890 (citing *Field*, 516 U.S. at 69).

31. *See id.* (citing *Field*, 516 U.S. at 69). This is the standard that the Court created in *Field* to evaluate a misrepresentation under the statute. *Field*, 516 U.S. at 72.

32. *McClellan*, 217 F.3d at 892. The Seventh Circuit noted that *Field* involved a misrepresentation between the parties and was litigated under a different term of the statute. *Id.* *McClellan* was tried under the “actual fraud” provision of the statute, and therefore *Field* does not directly control. *Id.*

the “actual fraud” provision of the statute.³³ Using canons of construction, such as the rule against surplusage,³⁴ the Seventh Circuit determined that by including both the terms “false representation” and “actual fraud” in the statute, Congress clearly intended for “actual fraud” to encompass more than just situations of affirmative deceit.³⁵ Furthermore, considering that the purpose of the Code was to provide relief to honest debtors, the court ruled that this sort of runaround involving a debtor being able to transfer valuable property to another for inadequate consideration in order to circumvent a creditor “is as blatant an abuse of the Bankruptcy Code as we can imagine” and turns the Code into “an engine for fraud.”³⁶

When considering § 523(a)(2)(A), the court determined that the provision recognizes the difference between “actual fraud” and “constructive fraud” and serves to except from discharge the “actual fraud” variety.³⁷ Compared to constructive fraud, which exists regardless of the transferee’s intent to deceive and includes situations where honest debtors were unfortunate in their business ventures, “actual fraud” is a term meant to recognize the transferee’s intent and complicity to join the fraudulent enterprise.³⁸ The court determined that this distinction excepts from discharge a debt that was transferred to hinder a creditor because of the transferee’s intent to defraud the creditor, regardless of whether a misrepresentation was made.³⁹

McClellan argued (and ultimately proved) that Cantrell knowingly participated in her brother’s scheme to avoid repayment and intended to defraud McClellan,⁴⁰ making her acquisition of the machinery one obtained by fraud.⁴¹ For those reasons, the court determined that § 523(a)(2)(A) was satisfied without a misrepresentation and ruled that the debt was excepted from discharge.⁴²

The First Circuit adjudicated a similar set of facts in *Lawson* and also determined that a misrepresentation was not a required element of actual

33. *Id.* at 892–93.

34. The rule against surplusage is a canon of construction that dictates that each term used in a particular statute must be given a unique meaning from the other terms used; otherwise, it would be redundant. Daniel A. Farber & Brett H. McDonnell, “*Is There a Text in This Class?*” *The Conflict Between Textualism and Antitrust*, 14 J. CONTEMP. LEGAL ISSUES 619, 630 (2005) (citing WILLIAM ESKRIDGE ET AL., LEGISLATION AND STATUTORY INTERPRETATION 267 (2000)).

35. *McClellan*, 217 F.3d at 893.

36. *Id.*

37. *Id.* at 894 (citing *Neal v. Clark*, 95 U.S. 704, 709 (1877)).

38. See H.R. REP. NO. 95-595, at 129–30 (1977). For further discussion on the difference between “actual fraud” and “constructive fraud,” see *infra* Part III.B.

39. See *McClellan*, 217 F.3d at 894–95.

40. See *id.*

41. *Id.* A debt is not something you obtain; it is something incurred as a consequence of receiving something of value from another person (a creditor). *Id.* Here, Cantrell received the machinery from her brother, not the creditor, which strains the statutory language of the term “obtained by” in the context of a debt. *Id.* at 895. However, the court determined that the fraud in this scenario occurred when the brother transferred the property in order to avoid his obligations with the creditor. *Id.* That makes the property obtained by Cantrell property obtained by fraud and within reach of § 523. *Id.*

42. *Id.* at 894.

fraud, as the only necessary condition is the debtor's intent to defraud.⁴³ This decision created a circuit split, as it expressly disagreed with a Fifth Circuit opinion from earlier that year.⁴⁴

In *Lawson*, Sauer Inc. had won a judgment against James Lawson from prior business dealings that were fraudulent.⁴⁵ To prevent Sauer from collecting, Lawson transferred funds to a shell entity owned by his daughter, the declarant in the bankruptcy petition.⁴⁶ Sauer quickly noticed the transfer and sued Ms. Lawson to recover the funds, leading her to file for Chapter 13 bankruptcy to discharge the debt. Sauer objected to the discharge under § 523(a)(2)(A), alleging that Lawson obtained the debt from her father via actual fraud.⁴⁷

In its analysis of “actual fraud,” the First Circuit agreed with the Seventh Circuit in ruling that the canons of construction require a broader reading of the statute, and the term “actual fraud” must include more than just a misrepresentation; otherwise the text would be redundant.⁴⁸ Furthermore, the court looked to section 871 of the Restatement (Second) of Torts to determine the definition of “actual fraud” when the statute was written.⁴⁹ This section defines fraud as the act of intentionally depriving another of their legally protected property interest.⁵⁰ The court interpreted this definition, as well as the holding in *McClellan*, to determine that the primary element of “actual fraud” is the transferee's intent to deceive the creditor and can occur without a misrepresentation.⁵¹ The court believed that this reading most closely followed the intent of Congress, the history of bankruptcy practice, and the tradition of “affording relief only to an ‘honest but unfortunate debtor.’”⁵²

*B. Of Course Misrepresentation Is Required:
The Fifth Circuit Will Not Except Debts Under
§ 523 Without Misrepresentation*

A couple of months before the First Circuit decided *Lawson*, the Fifth Circuit adjudicated a similar case in *Ritz* and reached a different result than

43. *Lawson v. Sauer Inc.* (*In re Lawson*), 791 F.3d 214, 220 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113).

44. *See id.* at 216 n.1 (citing *Husky Int'l Elecs., Inc. v. Ritz* (*In re Ritz*), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145)).

45. *Id.* at 216.

46. *Id.* at 216–17.

47. *Id.* at 217.

48. *Id.* at 220 (citing *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000)).

49. *Id.* at 219. Section 871 defines the perpetration of fraud as the act of “[o]ne who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and [when the perpetrator's conduct is] not justifiable under the circumstances.” RESTATEMENT (SECOND) OF TORTS § 871 (AM. LAW INST. 1979); *see also infra* Part II. This section of the Restatement is different from the one used in *Ritz*. *Ritz*, 787 F.3d at 318–19 (citing RESTATEMENT (SECOND) OF TORTS § 537).

50. RESTATEMENT (SECOND) OF TORTS § 871.

51. *See Lawson*, 791 F.3d at 222.

52. *Id.* (quoting *Cohen v. de la Cruz*, 523 U.S. 213, 217–18 (1998)).

the Seventh and First Circuits, by requiring a misrepresentation from the debtor for a debt to be excepted from discharge for “actual fraud.”⁵³

In *Ritz*, Chrysalis, a company in which Mr. Ritz was the controlling director, acquired electronic components from Husky International Electronics, Inc. for \$163,999.38 to be paid at a later date, thus creating a debt to Husky.⁵⁴ Over the next two years, Ritz quietly transferred \$1.16 million—including the incurred debt—to seven different corporate entities that he controlled before Husky filed suit to hold Ritz personally liable for the debt.⁵⁵ Subsequent to the suit, Ritz filed for Chapter 7 bankruptcy to discharge the debt, which led to Husky objecting under § 523(a)(2)(A), alleging that the funds were obtained via actual fraud.⁵⁶

In ruling that a misrepresentation is required to constitute “actual fraud,” the Fifth Circuit criticized the Seventh Circuit’s holding in *McClellan*, stating that it created tension with the Supreme Court’s opinion in *Field*, which it believed was controlling, even though it concerned the misrepresentation provision of § 523.⁵⁷ The court largely followed the same method of analysis as the Supreme Court in *Field*, by looking at definitions of “actual fraud” as it was understood in 1978, to attribute meaning to the term.⁵⁸ The Fifth Circuit even used the same section of the Restatement (Second) of Torts as the Supreme Court in *Field* to attribute meaning to “actual fraud.”⁵⁹ This section concerns justifiable reliance of a misrepresentation⁶⁰ (the issue of contention in *Field*), not actual fraud, which was the issue of contention in *Ritz*.

The court went on to suggest that the addition of the term “actual fraud” to the statute was not meant to create a new category for dischargeability, but to codify the limited scope of fraud reflected in case law at the time of enactment.⁶¹ The court noted that this limited scope was meant to recognize actual fraud and exclude the constructive category, but it did not

53. *Husky Int’l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 321 (2015) *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145).

54. *Id.* at 314.

55. *Id.* Husky attempted to pierce the corporate veil of Chrysalis to hold Ritz personally liable for the debt. *Id.* at 315. Under Texas law, the director of a company must engage in “actual fraud” in order to pierce the veil. *See* TEX. BUS. ORGS. CODE ANN. § 21.223(b) (West 2015). The court did not address this issue as it found that “actual fraud” did not occur under the Bankruptcy Code, making the veil-piercing question irrelevant. *Ritz*, 787 F.3d at 316.

56. *Ritz*, 787 F.3d at 316. Husky alleged that Ritz perpetrated an “actual fraud” by transferring the funds to other entities with the intention of avoiding payment. *Id.*

57. *Id.* at 317 (citing *Field v. Mans*, 516 U.S. 59 (1995)). In contrast, *Ritz* was petitioned under the “actual fraud” provision of § 523. *Id.*

58. *Id.* at 317–18 (citing *Field*, 516 U.S. at 70).

59. *Id.* 318–19 (citing RESTATEMENT (SECOND) OF TORTS § 537 (AM. LAW INST. 1979); W. PAGE KEETON & WILLIAM L. PROSSER, PROSSER AND KEETON ON THE LAW OF TORTS § 108, at 794 (4th ed. 1971)). The Supreme Court used section 537 of the Restatement (“Misrepresentation”) to adjudicate *Field*. *See Field*, 516 U.S. at 70. The Fifth Circuit acknowledged that this section deals with misrepresentation but was not appropriate here because it was bound by *Field*, and Husky had not pointed to any other provision of the Restatement that was more applicable. *Ritz*, 787 F.3d at 318 n.9.

60. *See* RESTATEMENT (SECOND) OF TORTS § 537.

61. *Ritz*, 787 F.3d at 320.

evaluate Ritz's actions in relation to this definition.⁶² The court simply noted that a distinction existed before discussing other issues.⁶³

Additionally, the court argued that § 523 does not encompass Ritz's transfers (although as both the transferor and transferee, he clearly acted with intent to defraud), as a separate provision of the Code was meant to handle these sort of fraudulent transfers.⁶⁴ The court questioned why Husky did not pursue recovery under § 727 in its opposition to Ritz's discharge, but it may have overlooked a part of the statute.⁶⁵ First, § 727 is only applicable to Chapter 7 bankruptcies,⁶⁶ which was satisfied here, as Ritz filed for bankruptcy under Chapter 7.⁶⁷ However, § 727 only excepts fraudulent discharge with intent to hinder or delay a creditor if the act was done within one year prior to filing the petition for bankruptcy.⁶⁸ Here, Ritz transferred funds into his other companies two to three years before he filed for bankruptcy,⁶⁹ making his activity outside of the scope of § 727 and preventing Husky from recovery under the statute. Husky would have had to monitor Ritz and Chrysalis's activities closely for several years and acted earlier in order to recover under § 727.

The decision to allow the debt to be discharged is peculiar from an outside perspective, as it seems to allow the use of the Code to perpetuate fraudulent activity. Husky pointed out that the case seemed strange for those involved as well, including the U.S. Bankruptcy judge that originally heard the case, who urged Husky to appeal the decision and remarked *sua sponte*:

I think [Ritz] drained Chrysalis of a lot of money. . . . I think he was *trying* to drain that company. . . . I don't think I've ever said this on the record, but I'm going to say it now. I hope you do appeal me. I hope an Appellate Court tells me I'm wrong, because I don't believe Mr. Ritz. I think he was trying to drain that company.⁷⁰

The differences in the seemingly analogous cases of *Ritz* and *Lawson* highlight the confusion that currently exists among the appellate courts in the interpretation of the "actual fraud" provision of § 523(a)(2)(A).⁷¹ Both

62. *See id.*

63. *See id.*

64. *Id.* The court was referring to 11 U.S.C. § 727(a)(2) (2012), which excepts discharge where "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor" within one year of filing the bankruptcy petition. This provision focuses on the transferor of the debt (the original debtor), not the recipient of the fraudulent transfer. *Id.*

65. *Id.* at 320–21.

66. *See* 11 U.S.C. § 727; *infra* Part III.

67. *See Ritz*, 787 F.3d at 315.

68. *See* 3 COLLIER BANKRUPTCY MANUAL ¶ 727.02 (4th ed. 2012).

69. *Ritz*, 787 F.3d at 314–15. The transfers occurred between November 2006 and May 2007, and Ritz did not file for bankruptcy until December 2009. *Id.*

70. Brief for Petitioner at 10–11, *id.* (No. 14-20526). The bankruptcy court ruled that, despite the seemingly inequitable result, the debt was dischargeable as it was under the impression that absent an express misrepresentation, a debt is not excepted from discharge under § 523(a)(2)(A). *In re Ritz*, 459 B.R. 623, 635–36 (Bankr. S.D. Tex. 2011).

71. *Compare Ritz*, 787 F.3d 312 (holding that a misrepresentation is required to constitute "actual fraud" under the statute), *with* *Lawson v. Sauer Inc.* (*In re Lawson*), 791

cases involved the transfer of a debt incurred through normal circumstances to a party who acquiesced to hinder the collection of the debt, without misrepresenting the prospect of repayment.⁷² The losing party in each case filed a petition for certiorari in hopes of the Supreme Court resolving this statutory interpretation issue.⁷³ On November 6, 2015, the Supreme Court granted the petition in *Ritz*,⁷⁴ and it chose not to act on the petition from *Lawson*.⁷⁵

II. HOW DID WE GET HERE?: THE DEVELOPMENT OF AMERICAN BANKRUPTCY LAW

This part discusses the history of bankruptcy law in America, starting with its English origins, and explains how the Code became what it is today. Additionally, it discusses the concept of discharge (including § 523 and § 727), explains how it evolved throughout history, and examines its purpose in the Code. The concepts behind bankruptcy and discharge are integral to understanding the arguments in *Ritz* and *Lawson*.

A. Bankruptcy: As American As Apple Pie

Bankruptcy has been an important part of U.S. culture since the nation's conception. The Founding Fathers thought the uniform application of bankruptcy was so important that they gave the legislature the power to prescribe federal rules and regulations for it in the Constitution.⁷⁶ The history of bankruptcy in the United States (like most of the country's legal system), however, begins long before the nation was formed and dates back to sixteenth-century England, as traditional English bankruptcy laws were considered when creating American bankruptcy law.⁷⁷ This section briefly discusses the origins of bankruptcy law in English culture, before explaining its incorporation into American law and its evolution through the Bankruptcy Reform Act of 1978. The Bankruptcy Reform Act is where

F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (holding that a misrepresentation is not a requirement for "actual fraud" under the statute).

72. See *Ritz*, 787 F.3d at 312; *Lawson*, 791 F.3d at 214.

73. See *Ritz*, 787 F.3d at 312; *Lawson*, 791 F.3d at 214.

74. *Husky Int'l Elecs., Inc. v. Ritz*, 787 F.3d 312, *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145).

75. SUPREME CT. U.S., <http://www.supremecourt.gov/search.aspx?filename=/docketfiles/15-113.htm> (last visited Apr. 29, 2016) (indicating, as of publication, that the Supreme Court has not granted or denied the petition for certiorari) [<https://perma.cc/9TT2-G2BX>].

76. U.S. CONST. art. I, § 8, cl. 4 ("Congress shall have Power To . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."). James Madison's *The Federalist No. 42* exemplifies the importance of bankruptcy to the Founding Fathers, which explained that bankruptcy is so connected with the regulation of commerce that the legislature must reserve the power to regulate it as well. THE FEDERALIST NO. 42 (James Madison). Madison's view was ultimately adopted in Article I, Section 8 of the U.S. Constitution. U.S. CONST. art. I, § 8, cl. 4.

77. See Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803).

most of the current Code was created—including § 523, which has stayed largely the same through the present.⁷⁸

In sixteenth-century England, debtors were treated as quasi-criminals in a system that heavily favored collectors.⁷⁹ The first bankruptcy laws were so collector friendly that only a creditor could commence a bankruptcy proceeding, and a debtor had no ability to discharge a debt.⁸⁰ This system allowed a creditor to file a bankruptcy proceeding, freeze the debtor's assets, sell the debtor's assets to recover proceeds pro rata, and continue to pursue the debtor individually if the full debt was not satisfied.⁸¹

Eventually, in 1732, England passed the bankruptcy statute that influenced the first unified American Bankruptcy Law in 1800.⁸² This English law incorporated concepts of voluntary discharge, capital punishment for unethical behavior, and involuntary proceedings against debtors initiated by creditors.⁸³ At its core, the bankruptcy law was (and to an extent still is) debt collection law that mandates how to treat those whose debts surpass their assets and how to determine which creditors are entitled to the limited assets that remain.⁸⁴

Although Congress was empowered by the Constitution to enact “uniform Laws on the subject of Bankruptcies,”⁸⁵ it did not enact permanent bankruptcy legislation until the Bankruptcy Act of 1898.⁸⁶ The Bankruptcy Act of 1898 was more debtor friendly than any prior temporary legislation, as it abolished many restrictions on discharge, limited the grounds of denial of discharge, and allowed a debtor's voluntary discharge.⁸⁷ Discharge in the context of the Code means that an individual's future earnings, inheritances, and gifts are free from the liabilities incurred in the past.⁸⁸ This allows an individual to start anew without creditors seizing their assets.

The 1898 version of the Code was a precursor to § 523 and contained similar provisions. Specifically, it prohibited discharge from debts that “are judgments in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another.”⁸⁹ The statute stayed in practice largely untouched

78. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 523, 92 Stat. 2549.

79. See Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 7–8 (1995).

80. *Id.* at 8 (citing 13 Eliz. 1, c. 7 (1570) (Eng.)).

81. *See id.*

82. *See id.* at 12 (citing Bankruptcy Act of 1800 ch. 19; 5 Geo. 2, c. 30 (1732) (Eng.)).

83. *Id.* at 10–12.

84. See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 3–4 (1986).

85. U.S. CONST. art. I, § 8, cl. 4.

86. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1978); see also Tabb, *supra* note 79, at 13–14. Before 1898, bankruptcy was governed either by temporary legislation that only remained active for several years or by state legislation. Tabb, *supra* note 79, at 13–14.

87. See Tabb, *supra* note 79, at 2425.

88. See JACKSON, *supra* note 84, at 227.

89. Bankruptcy Act of 1889, ch. 541, § 17(a)(2), 30 Stat. 544 (repealed 1978).

until the Bankruptcy Reform Act of 1978,⁹⁰ which revamped the entire Code and made it more or less what is today.⁹¹

B. Discharge: How Do Debts Disappear?

One of the purposes of the Bankruptcy Reform Act (and the enactment of discharge, in general) was to “give the debtor a less encumbered ‘fresh start’ after bankruptcy.”⁹² For this reason, discharge has been compared to a form of limited liability that exists for corporations, but instead for individuals.⁹³ While the Bankruptcy Reform Act was written to follow this clearly stated policy, it is important to note that there is no absolute right to discharge, as there are many exceptions in the Code, including those in § 523 and § 727.⁹⁴ The purpose of discharge is to provide relief for unfortunate debtors, and the exceptions exist to ensure that financial aid is only available to those who truly deserve it.⁹⁵ However, discharge also works to create a balance of rights between creditors and debtors, which is significantly related to risk allocation of lending.⁹⁶ The balancing of rights in this context greatly affects business through the monitoring of individuals’ credit decisions and the availability of funds that creditors are willing to offer, as a creditor will only advance funds if there is a high prospect of repayment.⁹⁷ This makes the balance vital, as a small shift can throw off the whole system and greatly affect the economy.

There are several statutes that govern the discharge of debts, but for the purpose of this Note, only § 523 and § 727 are relevant.⁹⁸ Section 727 is the general discharge statute, and it states that discharge should be construed liberally to allow the discharge of debts unless it is clearly limited by the text of the Code or by federal statute.⁹⁹ One exception to discharge provided by the Code is § 523, which prohibits discharge mostly for illicit behavior in order to conform to the purpose of the Code: to allow relief for unfortunate debtors.¹⁰⁰ Specifically, § 523(a)(2)(A) excepts discharge of a

90. Pub. L. No. 95-598, 92 Stat. 2549 (1978).

91. A few minor changes were made to the Code since 1978, including 11 U.S.C. § 523(a)(2)(A), which was amended in part ten times between 1979 and 2016. 11 U.S.C. § 523 (Supp. V 2012). However, the text of § 523(a)(2)(A) has remained largely the same throughout these amendments. For the purposes of this Note, the subtle differences in these amendments are not of importance.

92. S. REP. NO. 95-1106, at 1 (1978); *see also* JACKSON, *supra* note 84, at 225 (“[D]ischarge is viewed as granting the debtor a financial fresh start.”).

93. *See* JACKSON, *supra* note 84, at 22930 (comparing the concept of limited liability for large corporations to discharge for individual debtors).

94. *See* Theresa J. Pulley Radwan, *Determining Congressional Intent Regarding Dischargeability of Imputed Fraud Debts in Bankruptcy*, 54 MERCER L. REV. 987, 988 (2003).

95. *See* S. REP. NO. 95-1106, at 1.

96. *See* JACKSON, *supra* note 84, at 249.

97. *See id.* A creditor will not extend funds to individuals if there is a substantial risk of nonpayment, including discharge through bankruptcy. *Id.*; *see also infra* Part III.

98. *See* 11 U.S.C. §§ 523(a)(2)(A), 727 (2012).

99. *See* 3 COLLIER BANKRUPTCY MANUAL, *supra* note 68, ¶ 727.01[1].

100. *See* S. REP. NO. 95-1106, at 1.

debt “for money, property, [or] services . . . obtained by false pretenses, a false representation, or actual fraud.”¹⁰¹

If a creditor or adverse party objects to a debtor’s bankruptcy filing, they are given the right to file an objection, which prevents a court from automatically granting discharge and forces it to consider the bankruptcy petition on its merits.¹⁰² Once creditors object to discharge, they obtain the burden to prove that the discharge is improper and must state the grounds for exception through an applicable exception in the Code.¹⁰³ It is through this procedure that courts have struggled to interpret § 523, particularly as to whether a misrepresentation must occur in order to constitute “actual fraud.”¹⁰⁴

An alternative to § 523 for a creditor to except a bankrupt’s discharge is § 727. Some believe that § 727 is the appropriate solution to the acts of those in *Ritz* and *Lawson*.¹⁰⁵ As previously stated, § 727 discusses discharge in general, but it also provides specific instances in which discharge is not appropriate and is only applicable to Chapter 7 bankruptcies.¹⁰⁶ Chapter 7 bankruptcy deals with the liquidation of debtors’ estates for all “persons” under the law.¹⁰⁷ Relevant to the cases that caused the circuit split, one of the exceptions included in § 727 prevents discharge by a debtor who transferred the property of a creditor within one year of filing a petition for bankruptcy “with intent to hinder, delay, or defraud a creditor.”¹⁰⁸ Once this is proven, a creditor who wishes to have their property returned can attempt to sue the original debtor, wait for him to declare bankruptcy and object under § 727, or turn to § 548 of the Code to attempt to void the transfer.¹⁰⁹ Section 548 states that

[t]he trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing petition, if the debtor voluntarily or involuntarily—(A) made such transfer or incurred

101. 11 U.S.C. § 523(a)(2)(A). The phrase “willful and malicious injuries to the person or property of another” was changed to the term “actual fraud” in the enactment of the Bankruptcy Reform Act of 1978. See Bankruptcy Act of 1889, ch. 541, § 17(a)(2), 30 Stat. 544 (repealed 1978).

102. See 11 U.S.C. § 4004(c)(1)(B).

103. *Id.* § 4005.

104. Compare *Husky Int’l Elecs., Inc. v. Ritz* (*In re Ritz*), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145) (holding that a misrepresentation is required to constitute “actual fraud” under the statute), with *Lawson v. Sauer Inc.* (*In re Lawson*), 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (holding that a misrepresentation is not a requirement to constitute “actual fraud” under the statute).

105. See *Ritz*, 787 F.3d at 320–21.

106. 11 U.S.C. § 727.

107. 1 COLLIER BANKRUPTCY MANUAL, *supra* note 68, ¶ 109.09[3] (citing 11 U.S.C. § 109(b)). “Persons” under Chapter 7 includes individuals, corporations, and partnerships, but excludes governmental units. *Id.* ¶ 109.03[1].

108. 11 U.S.C. § 727 (a)(2).

109. See *id.* § 548.

such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted.¹¹⁰

However, it is important to note that there are several limitations to § 548 and § 727 that highlight why § 523 is necessary for situations like *Ritz* and *Lawson*. First, § 548 only allows a transaction to be voided by those who are acting on behalf of an estate as a trustee and will not permit a creditor to void a transfer if they are acting in an individual capacity and for their own benefit.¹¹¹ This is a broad exception that would prevent the creditors in both *Ritz* and *Lawson* from voiding the transfers. Second, § 727 only applies to fraudulent transactions related to Chapter 7 bankruptcies and only those that occur within one year of the petition for bankruptcy.¹¹² That makes § 727 inapplicable to cases such as *Lawson*, which was petitioned under Chapter 13,¹¹³ as well as *Ritz*, where the fraudulent transfers occurred more than one year prior to the petition for bankruptcy.¹¹⁴ Additionally, § 727 poses some difficulty in creditors obtaining a return on their property, as it only affects the illegal transferor, not the transferee that receives the funds in question.¹¹⁵ In a case like *Ritz* or *Lawson* (if we assume that they are both eligible for the exception under § 727), the creditor cannot object to the *recipient's* discharge under § 727, as the statute does not touch the recipient of such an illegal transfer, but rather only affects the transferor who no longer possesses the funds.¹¹⁶ Put simply, the creditor would not be able to take direct action against the party that possesses the goods or funds in question and would have to initiate a separate suit against that third party or hope that the original debtor is solvent to recover against in a direct suit against them.

Without an additional denial of discharge, creditors would either find themselves prohibited from recovering their property or forced into a situation where a third party (likely unfamiliar to the creditor) is added to the fray, requiring multiple suits. This would cause confusion, unnecessary transaction costs, and increased litigation costs for creditors, in turn making lending less attractive and more complicated. Such an inequitable reading of the statute would go against the purpose of the Code, which, in addition to granting relief to honest debtors, is supposed to recognize the rights of creditors.¹¹⁷ This highlights the purpose and the importance of § 523 reaching the original debtor.

110. *Id.* § 548(a)(1)(A).

111. See 3 COLLIER BANKRUPTCY MANUAL, *supra* note 68, ¶ 548.02 [4].

112. See *id.* ¶ 727.02.

113. See *Lawson v. Sauer Inc. (In re Lawson)*, 791 F.3d 214, 217 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113).

114. See *Husky Int'l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 314–15 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145). Ritz transferred the funds to his other entities two to three years before filing for bankruptcy. *Id.*

115. See 11 U.S.C. § 727(a)(2)(A).

116. *Id.*

117. See *Tabb*, *supra* note 79, at 10. It is important to note that increased rights to debtors, and discharge in general, are relatively new concepts in bankruptcy law, which originally only recognized the rights of creditors. *Id.*; see also *infra* Part III.

III. MISREPRESENT THIS:
§ 523 DOES NOT REQUIRE MISREPRESENTATION

The difference in opinions between the Fifth and First Circuits identifies a major interpretive discrepancy in § 523.¹¹⁸

The focal point of the circuit courts' disagreement is statutory interpretation and the congressional intent behind § 523. As discussed, § 523 specifically excepts from discharge a debt "for money, property, [or] services . . . obtained by false pretenses, a false representation, or actual fraud."¹¹⁹ Essentially, the disagreement in the circuits stems from the question: What does "actual fraud" mean under the statute, and what are its required elements? Statutory interpretation and its methods are much-discussed topics that foster strong opinions and little consensus.¹²⁰ For purposes of this Note, both the legislative history and the textual analysis have merit and are helpful in deciphering § 523.

By analyzing the statute, it is clear that contrary to the Fifth Circuit's belief, a reading of § 523 that requires misrepresentation to constitute "actual fraud" (1) is contrary to the legislative history of the statute and prior case law construing the statute; (2) is contrary to the plain meaning of the text of the statute; (3) is contrary to the purpose of the Code; (4) is inapplicable with respect to modern transactions (i.e., credit card transactions); and (5) fails to balance the rights between creditors and debtors. For these reasons, it is clear that § 523 does not require a misrepresentation to except from discharge a debt obtained by "actual fraud."

A. Legislative History and Prior Case Law

By looking at the legislative history of § 523, as well as prior cases that have analyzed the statute, it is possible to attribute meaning to a term that has proven problematic to define. It is clear from both the legislative history, as well as a prior Supreme Court case that analyzed § 523,¹²¹ that "actual fraud" is meant to encompass scenarios where the transferee intended to defraud a creditor, regardless of the presence of a misrepresentation. Thus, the transferees' intent to defraud is paramount to determine if they committed "actual fraud."

118. *See supra* Part I.

119. 11 U.S.C. § 523 (a)(2)(A).

120. For more information on the theories of statutory interpretation, see ROBERT A. KATZMANN, *JUDGING STATUTES* (2014), which advocates that a thorough inquiry into legislative history is necessary to accurately interpret a statute, and ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* (2012), which criticizes the use of legislative history in understanding a statute, while advocating for the use of methods that focus solely on the words used in the statute itself. For further discussion on the current state of judicial statutory interpretation, see Abbe R. Gluck, *What 30 Years of Chevron Teach Us About the Rest of Statutory Interpretation*, 83 *FORDHAM L. REV.* 607 (2014).

121. *Field v. Mans*, 516 U.S. 59 (1995).

1. Legislative History:
Attributing Meaning Based on Congressional Intent

The legislative history of § 523 lends support to the idea that by using the term “actual fraud,” Congress sought to codify a transferor’s fraudulent intent and was not concerned with a misrepresentation.¹²² The legislative history behind § 523 is admittedly scarce and leaves few clues as to what Congress intended by the term “actual fraud.”¹²³ This is one of the reasons why the Supreme Court coined this provision of the statute as a “term[] of art” that takes on common law meaning.¹²⁴ However, while there might not be much in the legislative history that illustrates legislative intent,¹²⁵ what does exist provides vital insight. According to Congress, when it crafted the statute, “actual fraud” was added as a separate ground for exception to discharge,¹²⁶ and it was made clear that “subparagraph (A) is intended to codify current case law e.g. *Neal v. Clark*, which interprets ‘fraud’ to mean actual or positive fraud rather than fraud implied in law.”¹²⁷ This distinction inherently highlights Congress’s intent to penalize behavior that falls under the “actual fraud” variety and is consistent with the holding in *Neal v. Clark*,¹²⁸ while ignoring behavior that is merely “constructive fraud” or “fraud implied in law.”¹²⁹

Neal, which was codified in § 523(a)(2)(A) and provided Congress with definitions for “actual fraud” and “implied fraud,” concerned the interpretation of bankruptcy law in 1877, before a permanent federal statute was created.¹³⁰ The lawsuit focused on a will’s executor who sold bonds to Neal at a discount after Neal claimed that the estate was in debt to him for funds that had been advanced.¹³¹ Neal subsequently sold the bonds to a third party.¹³² The same year, a suit was initiated against the executor to obtain a settlement of the distribution of the estate.¹³³ As a result, the executor was forced to issue a new bond with Clark as a surety.¹³⁴ About seven years after the executor had become insolvent, Clark sued Neal seeking the value of the bonds, alleging that the executor committed a

122. See S. REP. NO. 95-989 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787; H.R. REP. NO. 95-595 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963.

123. See S. REP. NO. 95-989, as reprinted in 1978 U.S.C.C.A.N. 5787; H.R. REP. NO. 95-595, as reprinted in 1978 U.S.C.C.A.N. 5963.

124. See *Field*, 516 U.S. at 70.

125. See Radawan, *supra* note 94, at 998.

126. See S. REP. NO. 95-989, at 78, as reprinted in 1978 U.S.C.C.A.N. 5864.

127. 124 CONG. REC. H11,089, at 32,399 (daily ed. Sept. 28, 1978) (statement of Hon. Don Edwards) (citation omitted).

128. 95 U.S. 704 (1877).

129. For further discussion on the differences between “actual fraud” and “constructive fraud,” see John C. McCoid II, *Constructively Fraudulent Conveyances: Transfers for Inadequate Consideration*, 62 TEX. L. REV. 639 (1983).

130. See *Neal*, 95 U.S. 704; see also Bankruptcy Act of 1889, ch. 541, 30 Stat. 544 (1898) (repealed 1978); see also *supra* Part II.

131. *Neal*, 95 U.S. at 704.

132. *Id.*

133. *Id.*

134. *Id.* at 705.

devastavit of the estate and that Neal was a liable participant.¹³⁵ Neal subsequently filed for bankruptcy seeking to discharge the bonds he received, to which Clark objected, citing an exception to discharge under a statute similar to § 523, which dealt with fraud or embezzlement.¹³⁶

In its opinion, the Court discussed the meaning of fraud in the statute and determined that it referred to positive fraud (actual fraud), not fraud implied by the law (constructive fraud).¹³⁷ The Court noted that positive fraud in the context of bankruptcy is closely related to debts created by embezzlement and requires an element of “moral turpitude” or intentional wrongdoing.¹³⁸ Conversely, it determined that implied fraud occurs when the participant is an honest citizen who did not act with bad faith or immorality, but was unfortunate in his ventures.¹³⁹ The Court believed that this interpretation was aligned with the intention of Congress in enacting bankruptcy law to aid honest citizens “from the burden of hopeless insolvency.”¹⁴⁰ Under this framework, the Court determined that Neal did not act with the intent to defraud Clark, thus allowing him to utilize the Code to discharge his debt.¹⁴¹

By specifically requiring “actual fraud” in order to except discharge, as opposed to implied fraud or fraud in general, Congress did not intend to require an explicit misrepresentation, but was instead concerned with the transferor’s intent and the transferee’s complicity in the enterprise. Congress had the opportunity to enact a statute with the term “fraud,” but instead chose to use the term “actual fraud.” By using “actual fraud” in § 523, Congress acknowledged a clear distinction between the terms and decided that actions that fit the definition of “actual fraud” were meant to be excepted from discharge, but not those that only fit the definition of “fraud” or “implied fraud.”¹⁴²

The distinction provides that a fraud obtained with moral turpitude or bad faith (actual fraud) shall not be dischargeable, but one obtained without such intent can be freely discharged.¹⁴³ This reading implies that wrongdoing or intent to defraud is more important than misrepresentation. Surely, one can intend to defraud a creditor without making an explicit misrepresentation. This shows that Congress did not intend to require a misrepresentation to constitute actual fraud, but meant to codify the traditional common law term concerning the transferee’s intent.

135. *Id.* *Devastavit* is a Latin term meaning “[t]he mismanagement of a decedent’s estate by an administrator.” *Devastavit*, BLACK’S LAW DICTIONARY (10th ed. 2014).

136. *See Neal*, 95 U.S. at 705 (citing Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (repealed 1878)). This section of the 1867 Code provides that “no debt created by the fraud or embezzlement of the bankrupt . . . shall be discharged under this act.” Bankruptcy Act of 1867, ch. 176. This statute was the predecessor to what is now § 523.

137. *Neal*, 95 U.S. at 709.

138. *Id.*

139. *Id.*

140. *Id.*

141. *See id.*

142. *See* H.R. REP. NO. 95-595, at 129–30 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963.

143. *Id.*

2. Case Law: Attributing Meaning Based on the Supreme Court's Jurisprudence

In *Field v. Mans*, the Supreme Court analyzed part of § 523 in a manner that provides insight into the current issue.¹⁴⁴ While this case is not entirely analogous to the cases that split the circuits in 2015, it concerned a separate term of the statute¹⁴⁵ that prompted differing levels of reliance among the circuit courts in evaluating “actual fraud.”¹⁴⁶ While the circuits relied on *Field* differently, they agreed that the method that the Supreme Court used in reaching its decision was proper.¹⁴⁷

In the case, Field sold real estate to a corporation owned by Mans, who paid with cash and a promissory note in the form of a second mortgage.¹⁴⁸ The mortgage deed contained a clause requiring Field's consent to any conveyance of the land during the term of the mortgage.¹⁴⁹ If Mans conveyed the property without permission, the entire unpaid balance of the note would become due immediately.¹⁵⁰ Four months after the deal was agreed upon, Mans conveyed the property to his newly formed partnership before asking Field's consent, thus triggering the clause in the note making the unpaid balance due immediately.¹⁵¹ Mans asked Field the day after the conveyance was made to waive the “due on sale” clause, but Field did not consent.¹⁵² Mans never informed Field of the transfer and did not discuss the topic further.¹⁵³ Three years later, due to plummeting real estate prices, Mans petitioned for bankruptcy relief under Chapter 11 of the Code.¹⁵⁴ Field then learned of the conveyance and objected to Mans's discharge, alleging that \$150,000 had become due upon the conveyance and, by breaching the contract, Mans had obtained it by fraud.¹⁵⁵

144. *Field v. Mans*, 516 U.S. 59 (1995).

145. *See id.* at 441–42 (referring to “misrepresentation” under 11 U.S.C. 523(a)(2)(A) (2012)).

146. *Compare* *Husky Int'l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 317 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145) (considering *Field* to be controlling on the issue of “actual fraud”), *with* *Lawson v. Sauer Inc. (In re Lawson)*, 791 F.3d 214, 218–19 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (rejecting the level of reliance that the Fifth Circuit placed on *Field* in interpreting “actual fraud”).

147. *See Ritz*, 787 F.3d at 318; *Lawson*, 791 F.3d. at 219.

148. *Field*, 516 U.S. at 61.

149. *Id.* at 61–62.

150. *Id.* at 62.

151. *Id.* The conveyance was meant to be a contribution to Mans's land development organization. *Id.*

152. *Id.* Mans never asked for Field's consent to convey the property, but only asked for a waiver of his rights after the property was conveyed. *Id.* The waiver request never informed Field that the property already had been conveyed, but led to a negotiation between Field and Mans concerning an appropriate price to pay for the waiver, which was ultimately never agreed upon. *Id.*

153. *Id.*

154. *Id.* Chapter 11 of the Code in this context refers to a small business debtor seeking relief for a debt not exceeding \$2,000,000. 11 U.S.C. § 101(51D)(A) (2012).

155. *Field*, 516 U.S. at 62 (citing 11 U.S.C. § 523(a)(2)(A)). The petition initially sought to except the discharge under the “actual fraud” provision of § 523, but the court believed that the “misrepresentation” provision was more appropriate. *Id.* at 62–63.

Unlike *Ritz* and *Lawson*, which analyzed the statute as it related to “actual fraud,” the Court in *Field* analyzed the complaint under the misrepresentation provision and granted certiorari to resolve a conflict in the circuits regarding the level of reliance a creditor must demonstrate on the misrepresentation to except discharge.¹⁵⁶

The Court looked at the operative terms of the statute (“false pretenses,” “false representation,” and “actual fraud”) to determine that these words were terms of art that have a basis in common law, and “[i]t is . . . well established that ‘where Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer . . . that Congress means to incorporate the established meaning of these terms.’”¹⁵⁷ To determine the meaning of the terms of the statute, the Court looked to definitions dated from when the language was added in 1978.¹⁵⁸ Ultimately, through analysis of the sources, the Court determined that the statute required only a reasonable level of reliance in ruling that Mans’s debt should not be discharged.¹⁵⁹ While the holding in this case is not of the utmost importance to the subsequent cases that deal with “actual fraud,” courts have used this method of analysis to attribute meaning to “actual fraud,” but have differed in their execution of it, as well as the weight given to the holding in *Field*, thus resulting in a circuit split.¹⁶⁰ To reach a uniform application of the statute, courts must agree on the appropriate sources of interpretation, as well as a determination that *Field* is not directly controlling on cases of “actual fraud.”

B. Text: What Did the Terms Mean When the Statute Was Enacted?

Another method of interpreting statutes is analyzing the plain meaning of the words that Congress chose to codify in the text when it was written.¹⁶¹ The Supreme Court used this method to decipher § 523 in *Field*, albeit regarding a different term of the statute.¹⁶² By looking at the appropriate

156. *Id.* at 63 n.4 (citing *In re Mayer*, 51 F.3d 670 (7th Cir. 1995); *In re Allison*, 960 F.2d 481 (5th Cir. 1992); *In re Burgess*, 955 F.2d 134 (1st Cir. 1992); *In re Ophaug*, 827 F.2d 340 (8th Cir. 1987); *In re Mullet*, 817 F.2d 677 (10th Cir. 1987)).

157. *Id.* (quoting *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989)).

158. *Id.* at 70. The inquiry focused on the Restatement (Second) of Torts from 1976, as well as an edition of Prosser’s *Law of Torts* that was available in 1978. *Id.* at 70–71, 76 (citing H.R. REP. NO. 95-595 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963; RESTATEMENT (SECOND) OF TORTS §§ 537, 540, 545A cmt. B (AM. LAW INST. 1979); KEETON & PROSSER, *supra* note 59, at 794).

159. *Id.* at 77.

160. Compare *Husky Int’l Elecs., Inc. v. Ritz* (*In re Ritz*), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 136 S. Ct. 445 (2015) (No. 15-145) (requiring a formal misrepresentation by a debtor in order to constitute “actual fraud” under the statute), with *Lawson v. Sauer Inc.* (*In re Lawson*), 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (rejecting the misrepresentation requirement used by the Fifth Circuit), and *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) (using canons of construction and legislative history to rule that misrepresentation is not required under the statute).

161. See generally SCALIA & GARNER, *supra* note 120.

162. See *Field*, 516 U.S. at 70–71.

sources of interpretation from the time the statute was written (e.g., dictionaries, Restatements, and treatises), it is clear that “actual fraud” refers to the First Circuit’s ruling in *Lawson*, and concerns the transferor’s intent, not what he may or may not say as a misrepresentation.¹⁶³

One tool used to find the definition of a term is the Restatement—in this case, the Restatement (Second) of Torts. Because the Restatement (Second) of Torts was written in 1979, its definitions provide insight into § 523, which was codified in 1978. One issue that has caused further confusion among the circuits is determining which section of the Restatement applies to “actual fraud.” The First Circuit applied section 871,¹⁶⁴ while the Fifth Circuit followed the Supreme Court in *Field* and applied section 537 to reach its decision.¹⁶⁵ However, the Restatement shows that section 871 is applicable to the conduct that occurred in these cases and actual fraud in general, not section 537.

Restatement section 871 is titled “Intentional Harm to a Property Interest” and states that “[o]ne who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances.”¹⁶⁶ Furthermore, the comments state, “[T]he rule applies when title to land has been obtained by fraud or duress and has been transferred to one other than a bona fide purchaser.”¹⁶⁷ Additionally, the comments provide that “actual fraud” “applies when one has interfered with the possessory interests of another in land or chattels, either by causing harm to the subject matter or by depriving the other of possession.”¹⁶⁸ The definition and the comments show that more important than a transferor’s misrepresentation (or lack thereof) is the transferor’s intent to defraud, as the term encompasses the transfer of property under general culpable or fraudulent behavior.

On the other hand, section 537 was used by the Supreme Court in *Field*, as part of its analysis of the term “misrepresentation.”¹⁶⁹ The Fifth Circuit also used this section in *Ritz*, as it believed that *Field* was controlling, and because Husky did not identify a more appropriate section to use.¹⁷⁰ The section states the general rule for the level of reliance a recipient of a fraudulent misrepresentation must show in order to recover against the transferor.¹⁷¹ This is only relevant when assessing the level of reliance required when the debtor makes an affirmative misrepresentation under the “misrepresentation” prong of the statute.¹⁷² It does not serve a purpose when assessing behavior under the “actual fraud” provision, as “actual

163. *Lawson*, 791 F.3d at 222.

164. *Id.* at 219 (citing RESTATEMENT (SECOND) OF TORTS § 871 (AM. LAW INST. 1979)).

165. *Ritz*, 787 F.3d at 318–19 (citing RESTATEMENT (SECOND) OF TORTS § 537).

166. RESTATEMENT (SECOND) OF TORTS § 871.

167. *Id.* § 871 cmt. a.

168. *Id.*

169. *See Field v. Mans*, 516 U.S. 59, 70 (1995).

170. *See Ritz*, 787 F.3d at 318–19, 318 n.9.

171. RESTATEMENT (SECOND) OF TORTS § 537.

172. *See Field*, 516 U.S. at 70.

fraud” does not necessarily require a misrepresentation to rely on. Using this section to analyze the meaning of “actual fraud” is severely constraining and does not fully represent what Congress intended to enact with § 523.

Black’s Law Dictionary from 1979 adds to the belief that “actual fraud” encompasses more than just misrepresentation, by distinguishing it from the term “fraud” in general. The dictionary defines fraud as “[a] false representation of a matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury.”¹⁷³ Based on this definition, it is easy to see how a court can read “actual fraud” to require a misrepresentation. However, the dictionary goes on to specify the types of fraud and includes a separate category to distinguish “actual fraud” from “constructive fraud.”¹⁷⁴ “Actual fraud” is defined as an act involving

deceit, artifice, trick, design, some direct and active operation of the mind; it includes cases of the intentional and successful employment of any cunning, deception, or artifice used to circumvent or cheat another. It is something said, done, or omitted by a person with the design of perpetrating what he knows to be a cheat or deception.¹⁷⁵

The distinction supports the belief that “actual fraud” encompasses more than just a misrepresentation. More important than whether a transferor makes a misrepresentation is the transferor’s intent to defraud or cheat. The distinction between “fraud” and “actual fraud” is important, as Congress chose to codify “actual fraud” when given the opportunity to decide between the terms and explicitly stated so.¹⁷⁶ Furthermore, *Collier Bankruptcy Manual*, the leading treatise on bankruptcy, lists *Black’s* definition for “actual fraud” as the correct definition of the term, and goes on to clarify that “actual fraud” (as opposed to fraud in general) concerns deception or deceit.¹⁷⁷

Slightly less applicable is Prosser’s *Law of Torts*, which allows a party to recover for the wrongful possession of chattel obtained by fraud, where the acquisition of the goods constitutes the wrongful act.¹⁷⁸

These sources show that there is a legal distinction between “general fraud” and “actual fraud.” “Actual fraud” is a term that is meant to encompass one’s fraudulent intent to obtain property that is not that person’s, where fraud in general is meant to encompass an act involving misrepresentation. By using the term “actual fraud” as opposed to just “fraud,” Congress meant to encompass more than just situations involving a

173. *Fraud*, BLACK’S LAW DICTIONARY (5th ed. 1979).

174. *Id.*

175. *Actual or Constructive Fraud*, BLACK’S LAW DICTIONARY (5th ed. 1979).

176. See 124 CONG. REC. H.11,089, at 32,399 (daily ed. Sept. 28, 1978) (statement of Hon. Don Edwards) (“Subparagraph (A) is intended to codify current case law . . . which interprets ‘fraud’ to mean actual or positive fraud rather than fraud implied in law.”).

177. 4 COLLIER BANKRUPTCY MANUAL, *supra* note 68, ¶ 523.08[1][d].

178. KEETON & PROSSER, *supra* note 59, at 794.

misrepresentation. Reading § 523 to require a misrepresentation to constitute “actual fraud,” as the Fifth Circuit did, is contrary to the definition of the term and is severely limiting in determining behavior that should be excepted from discharge.

Finally, it is possible to attribute meaning to a statute based on the other terms used in the statute. The rule against surplusage is a canon of construction that says, in a single statute, each term must be read to have a unique meaning from the other terms.¹⁷⁹ Otherwise, some terms would be considered superfluous or redundant and thus useless in contributing distinct meaning.¹⁸⁰ Courts have analyzed the terms of § 523 this way and have attempted to attribute a distinct meaning to each term of the statute.¹⁸¹ By looking at the definitions that courts have given to “false pretenses” and “false representations,” it is possible to construct a distinct definition of “actual fraud.” The distinction that courts have created supports the finding that “actual fraud” is meant to encompass a different type of behavior than constructive fraud. Specifically, it exists to penalize a debtor’s fraudulent intent. Additionally, it is clear that the term is meant to encompass more than just the misrepresentation requirement of fraud in general.

Courts’ analyses of the distinction between “false representation” and “false pretenses” are particularly helpful in this exercise. In a case concerning a bankruptcy proceeding used to avoid payment of a judicial order, a New York court highlighted this distinction.¹⁸² The court held that “[a]s distinguished from false representation, which is an express misrepresentation[,] false pretense involves an implied misrepresentation or conduct intended to create and foster a false impression.”¹⁸³ Reading the statute to require a misrepresentation to constitute both “false representation” and “actual fraud” would, in essence, codify the same thing twice, leaving one redundant or superfluous. Additionally, attributing this meaning to “false pretenses” creates a unique definition from “actual fraud” by requiring false impression. “Actual fraud” concerns the debtor’s intent and does not consider the creditor’s impression of the debtor. Reading the terms this way attributes a distinct meaning to each that is consistent with what Congress codified.

Additionally, the Supreme Court has held that the terms of § 523 “incorporate the general common law of torts.”¹⁸⁴ As a result, appellate courts have analyzed the “false representation” prong of § 523 to require six common law elements¹⁸⁵:

179. See Farber & McDonnell, *supra* note 34, at 630 (citing ESKRIDGE ET AL., *supra* note 34, at 267).

180. See *id.*

181. See *Palmacci v. Umpierrez*, 121 F.3d 781, 786–87 (1st Cir. 1997); *In re Hartley*, 479 B.R. 635, 642 (Bankr. S.D.N.Y. 2012); *In re Scarlata*, 127 B.R. 1004, 1009 (Bankr. N.D. Ill. 1991), *aff’d*, 979 F.2d 521 (7th Cir. 1992).

182. See *Hartley*, 479 B.R. at 642.

183. *Id.* (quoting *In re Weinstein*, 31 B.R. 804, 809 (Bankr. E.D.N.Y. 1983)); see also *Scarlata*, 127 B.R. at 1009 (citing *In re Guy*, 101 B.R. 961, 978 (Bankr. N.D. Ind. 1988)).

184. *Field v. Mans*, 516 U.S. 59, 70 n.9 (1995).

185. See *Palmacci*, 121 F.3d at 786.

Under the traditional common law rule, a defendant will be liable if (1) he makes a false representation, (2) he does so with fraudulent intent, i.e., with “scienter,” (3) he intends to induce the plaintiff to rely on the misrepresentation, and (4) the misrepresentation does induce reliance, (5) which is justifiable, and (6) which causes damage (pecuniary loss).¹⁸⁶

These six elements help create a meaning for false representation under § 523 distinct from “false pretenses” and “actual fraud” by requiring both a false representation *and* the creditor’s reliance. As previously discussed, “actual fraud” does not include misrepresentation or reliance from a creditor in its required elements. Reading “false pretenses” and “false representations” in this manner necessitates a reading of “actual fraud” that requires proof of the transferor’s intent and the transferee’s complicity in defrauding the creditor; this does not include the requirement of a misrepresentation.

C. *Aligning § 523 with the Purpose of the Code*

When the Code was rewritten in 1978, its primary purpose was to create a system that “give[s] the debtor a less encumbered ‘fresh start’ after bankruptcy.”¹⁸⁷ However, as previously discussed, there is no absolute right to discharge as demonstrated by the various exceptions written in the Code.¹⁸⁸ These exceptions were written with the idea of fairness in mind and were meant to ensure that financial relief is only available to those who were unfortunate in their ventures and truly deserve aid from the Code in order to start anew.¹⁸⁹ The exceptions exist to prevent dishonest debtors from avoiding their obligations by exploiting the Code for their personal benefit at the expense of their creditors. This concept of fairness, which guides much of the Code, lends support to the assertion that § 523 is meant to encompass various forms of fraudulent behavior and is not meant to be limited to acts of misrepresentation to constitute “actual fraud.”

Section 523 is no different from the general premise of fairness that exists throughout the Code. It was written to recognize that discharge is unavailable to those who obtain a debt via immoral means. “False pretenses,” “misrepresentation,” and “actual fraud” are all torts that involve illicitly acquiring something of value. Reading the term “actual fraud” to allow debtors such as Ritz or Lawson to reap the benefits of the Code because they did not misrepresent their fraudulent behavior is contrary to the purpose of both the Code and § 523. Limiting § 523’s “actual fraud”

186. *Id.* (citing 2 F. HARPER ET AL., LAW OF TORTS § 7.1, at 381 (2d ed. 1986); RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW INST. 1979)).

187. S. REP. NO. 95-1106, at 1 (1978); *see also* JACKSON, *supra* note 84, at 225 (“[D]ischarge is viewed as granting the debtor a financial fresh start.”).

188. *See supra* Part II.B.

189. *See* S. REP. NO. 95-1106, at 1 (discussing how the Bankruptcy Act—in addition to aiding debtors—serves to find an equitable balance for creditors seeking to recover a return on their property and to recognize the interests of unsecured creditors who would otherwise have no priority in recovery).

provision to require a misrepresentation would create a loophole that could turn the Code into an “engine for fraud.”¹⁹⁰

*D. Modernizing the Statute: Making § 523 Work
in the Context of Credit Card Transactions*

As discussed earlier, bankruptcy laws originally were created to aid creditors in their collection and have only somewhat recently softened their harsh stance on debtors.¹⁹¹ While the Code certainly has evolved to recognize the right for unfortunate debtors to start anew, it also serves to balance their rights with the rights of a creditor to recover what is rightfully his.¹⁹² In fact, Congress contemplated discharge and fairness in the same breath, writing the exceptions to allow only those who were unfortunate in their ventures to reap the benefits of the Code.¹⁹³

This is evident in the context of credit card fraud under § 523.¹⁹⁴ In credit card fraud cases, a purported purchaser does not misrepresent to the credit card company that he can pay for the items he charges, he just buys with the intent of not paying (or with the inability to pay).¹⁹⁵ Allowing a person to discharge a debt incurred by buying on credit when he or she is incapable of repaying a credit card company, because the debtor did not affirmatively misrepresent that he or she cannot pay, highlights a logical inconsistency in the text that does not conform to the Code.¹⁹⁶ Expanded to cases such as *Ritz* or *Lawson*, this logic would allow a fraudulent debtor to abscond from his obligations, leaving the rights of the creditor to go by the wayside. Such a reading would open the door to other Ritzes and Lawsons to perpetrate the same runaround using the Code as their aid.

*E. Finding the Correct Balance
Between Creditors and Debtors*

As previously stated, the Code, in part, serves to balance rights between creditors and debtors to establish a fair system of debt collection law.¹⁹⁷ The Supreme Court has stated that it “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”¹⁹⁸ Reading § 523 in such a way that prevents the creditor from collecting his funds would erode the past practice of balancing the parties’ interests. Additionally, it would grant a dishonest debtor the ability to escape liabilities that they knowingly take on, which

190. *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000).

191. *See supra* Part II.

192. S. REP. NO. 95-1106, at 1.

193. *See* 124 CONG. REC. H11,089, at 32,399 (daily ed. Sept. 28, 1978) (statement of Hon. Don Edwards) (stating that § 523(a) is meant to codify *Neal v. Clark*, 95 U.S. 704 (1877)).

194. *See* Steven H. Resnicoff, *Dischargeability in Bankruptcy of Debts Incurred by “Purported Purchasers”*, 64 ST. JOHN’S L. REV. 253, 257 (1990).

195. *See id.* at 256.

196. *Id.* at 256–57.

197. *See* JACKSON, *supra* note 84, at 3–4.

198. *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998).

would serve as a rash departure from the Code's purpose of providing only an honest and unfortunate debtor with relief.¹⁹⁹

Judge Posner summed up this issue in his analysis of *McClellan v. Cantrell*.²⁰⁰ He explained that

[t]he two-step routine that McClellan alleges and that we must take as true—in which Debtor *A* transfers valuable property to *B* for nothing in order to keep it out of the hand of *A*'s creditor and *B* then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with *A* to defeat the rights of *A*'s creditor—is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud.²⁰¹

Enforcement of the Code is integral to our society. Some argue that, like the way the government regulates various vices, it should regulate the way that borrowing and financial obligations are enforced.²⁰² The proper application of discharge serves as a balance between the rights of borrowers and creditors that influences the amount a creditor is willing to lend and dictates what a borrower should set aside if the business venture is not successful.²⁰³ Integral to this balance is determining which assets are available to creditors in a bankruptcy proceeding and which are not.²⁰⁴ Furthermore, in determining which debts are dischargeable in bankruptcy, a court must weigh the benefits of the “fresh start” policy against the harm deterred by the denial of discharge while considering the purpose of bankruptcy law.²⁰⁵

In cases like *Ritz* and *Lawson*, it is easy to see which way the scales lean. The harm of allowing debtors to circumvent the law and engage in fraud certainly outweighs that debtor's right to a fresh start. Any other reading of § 523, or the Code in general, would disrupt the balance that exists between the borrower's rights and the creditor's rights that could ultimately lead to a decrease in funds available for lending, create a general apprehension to lend, or increase monitoring in lending. It is possible that such a dramatic change in the balance of power could lead to significant economic repercussions for more than just the parties involved in a loan transaction.

The text and legislative intent of § 523 both indicate that “actual fraud” under the statute requires proof of intent of the receiving party to deceive the creditor, not to require a formal misrepresentation.²⁰⁶ However, some may argue that the distinction might be irrelevant, as there are still ways for

199. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *Williams v. U.S. Fidelity & Guar. Co.*, 236 U.S. 549, 554–55 (1915).

200. 217 F.3d 890 (7th Cir. 2000).

201. *Id.* at 893.

202. See JACKSON, *supra* note 84, at 248–49 (comparing the criminal code and taxation of cigarettes and alcohol to the federal limits that are put on borrowing and discharge in general).

203. *Id.* at 249.

204. *Id.* at 259.

205. *Id.* at 278.

206. See *supra* Part III; see also Resnicoff, *supra* note 194.

a creditor to recover.²⁰⁷ These proponents would argue that § 727 of the Code gives creditors an alternative method of recovery. The provision prevents fraudulent transfers and states that a discharge shall not be granted in a bankruptcy proceeding if “the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . or has permitted to be transferred . . . property of the debtor, within one year before the date of the filing of the petition.”²⁰⁸

This would apply to situations where the creditor seeks to collect his funds and the original debtor transfers the debt to a third party and files bankruptcy within a year of that transfer. But what happens if the transfer occurred more than one year before the bankruptcy petition? Or, how does the creditor recover if the original debtor has no means to repay his debts while the transferee possesses the funds and walks away scot-free? Or, what happens if the bankrupt files their petition for bankruptcy under a chapter other than Chapter 7? This will give the debtor a loophole to avoid his obligations and leave a creditor in a precarious situation. If § 523 is read to require a misrepresentation, this could leave the creditor out of luck in collecting on the debt and thus shift the balance of rights between creditors and debtors.

CONCLUSION

The Code exists to ensure that there is a proper balance between the rights of a creditor and the ability of a debtor to have a “less encumbered ‘fresh start’ after bankruptcy.”²⁰⁹ This is one of the reasons why § 523 was enacted: to ensure that debts obtained by “false pretenses,” “false representation,” or “actual fraud” are not able to reap the benefits of the Code.²¹⁰ However, this statute has proved to be problematic among the appellate courts, as a disagreement occurred concerning the requirements of “actual fraud.”²¹¹

By looking at the legislative history of the Code and prior case law, textual analysis, conformity to the purpose of the Code, application to modern transactions, and the balance that exists between creditor and debtor rights, this Note shows that § 523 does not require a misrepresentation to constitute “actual fraud.”²¹² A reading requiring a misrepresentation would permit an unworthy debtor to evade his obligations and reap the benefits of the Code, thus leaving an innocent lender without recourse and forced to pay for the debtor’s fraudulent actions.²¹³

207. See *Husky Int’l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 320 (5th Cir. 2015), cert. granted, 136 S. Ct. 445 (2015) (No. 15-145).

208. 11 U.S.C. § 727(a)(2)(A) (2012); see also *supra* Part II.B.

209. See S. REP. NO. 95-1106, at 1 (1978).

210. See 11 U.S.C. § 523(a)(2)(A).

211. Compare *Ritz*, 787 F.3d 312 (ruling that a misrepresentation is required to constitute “actual fraud” under the statute), with *Lawson v. Sauer Inc. (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015), petition for cert. filed, 2015 WL 4537882 (U.S. July 24, 2015) (No. 15-113) (ruling that a misrepresentation is not required to constitute “actual fraud” under the statute).

212. See *supra* Part II.

213. See *Ritz*, 787 F.3d 312.

The Supreme Court should resolve this issue and the circuit split that accompanies it, as it has the opportunity to establish a uniform application of a troublesome statute. It seems likely that the Court will rule in favor of the lenders in these cases and rule that “actual fraud” does not require a misrepresentation. Hopefully, such a ruling will limit the fraudulent activity of the Ritzes and Lawsons of the world and provide a system of discharge that is fair for everyone.