20th Annual Great Debates

Douglas E. Deutsch, Moderator
ABI Vice President-Education
Chadbourne & Parke LLP; New York

Resolved: Unsecured creditors entitled to post-petition interest can only be paid at the federal judgment rate.

Pro: Joseph H. Smolinsky
Weil, Gotshal & Manges LLP; New York

Con: Rachel C. Strickland
Willkie Farr & Gallagher LLP; New York

Resolved: Actual fraud under § 523(a)(2)(A) is limited to misrepresentation.

Pro: G. Eric Brunstad, Jr.
Dechert LLP; Hartford, Conn.

Con: Danielle Spinelli
WilmerHale; Washington, D.C.

Resolved: Negative-notice procedure is sufficient to establish consent under § 363(f).

Pro: Hon. Thomas J. Catliota
U.S. Bankruptcy Court (D. Md.); Greenbelt

Con: Hon. Martin R. Barash
U.S. Bankruptcy Court (C.D. Cal.); Woodland Hills

"Legal Rate" of Post-Petition Interest for Unsecured Creditors in Chapter 11 Case

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It is fairly well established that the Bankruptcy Code requires a solvent chapter 11 debtor to provide, in its plan of reorganization, for the payment to all unsecured creditors of the full value of their claims, in addition to post-petition interest on said claims through the confirmation date. What remains unclear, however, is the appropriate rate of interest to be applied to said claims in order that the plan may be fair and equitable and meet the requirements of the absolute priority rule. This article will discuss the available options under the governing Code provisions and advocate for the application of the unsecured creditors' contract rate of interest, and even the contractual default rate of interest, where available.


Daniel W. Sklar

Pursuant to 11 U.S.C. § 726(a)(5), once all allowed claims are paid in full, if assets remain in the estate, the debtor or trustee must make "payment of interest *at the legal rate* from the date of the filing of the petition, on any claim paid."[1] This Code section is made applicable to chapter 11 debtors by way of the so-called "best interest of creditors test" found in § 1129(a)(7),[2] and by the "absolute-priority rule" found in § 1129(b)(2), which requires that creditors receive payment of their claims in order of priority and in full before lesser claims or interests share in the assets of the reorganized debtor. Citing these Code sections, a number of courts have explicitly ruled that in the case of a solvent chapter 11 debtor, post-petition interest on allowed claims must be paid through the confirmation date before shareholders receive any type of distribution.[3]

While the concept itself is straightforward, none of the applicable Code sections defines the critical phrase "at the legal rate," and there is scant legislative history available to shed light on this statutory provision. Several interpretive options are available, and they may be broken down into two separate categories, one for the state law approach, and the other for the federal judgment rate approach.[4] Within the state-law approach, where a contract between the debtor and creditor exists, the contractual interest rate (default or non-default) may be applied, and absent a contract, a specific state statute may provide the applicable rate. Bankruptcy courts have split over the correct interpretation of this language.

Feature

Application of the Federal Judgment Rate

At least one circuit has determined that § 726(a)(5) mandates application of the federal judgment rate found in 28 U.S.C. § 1961(a). In *In re Cardelucci*,[5] the Ninth Circuit affirmed the district court's application of the federal interest rate to an award of post-petition interest made pursuant to § 726(a)(5). The creditors in question obtained a state-court judgment against the debtor, which was entered pre-petition. The debtor's plan of reorganization provided for payment of the judgment in full, together with post-confirmation interest at the rate of 5 percent and post-petition, pre-confirmation interest at a rate to be determined pursuant to the Code.[6] The parties agreed that post-petition, pre-confirmation interest must be paid, but disagreed as to the applicable interest rate. The claimants advocated for the California state statutory interest rate of 10 percent, and the debtor claimed the federal interest rate (at the time) of approximately 3.5 percent should apply.[7]


Holly J. Kilibarda

The Ninth Circuit adopted the reasoning of its own Bankruptcy Appellate Panel (BAP) in *In re Beguelin* (a chapter 13 case),[8] which concluded that the interests of "fairness, equality, and predictability in the distribution of interest on creditors' claims" as well as the interest in applying federal law to federal bankruptcy cases, required application of the federal judgment rate.[9] The court noted that Congress had specifically chosen the language "interest at the legal rate" in favor of the originally proposed "interest on claims allowed."[10] The use of the definite article "the," as opposed to the broader and more indefinite article "a," indicated Congress' intention that a single source be used to calculate post-petition interest, and the commonly understood meaning of "at the legal rate" at the time the Code was enacted was a rate fixed by statute, and a federal statute at that.[11] Additionally, the Ninth Circuit felt that using the federal rate promoted uniformity within federal law, as well as ease of administration.[12] The

1 Emphasis added.
2 Pursuant to § 1129(a)(7)(ii), with respect to each impaired class, each holder of a claim or interest of such class who has not accepted the plan must "receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7."
3 *See, e.g., In re Dow Corning Corp.*, 456 F.3d 668, 678 (6th Cir. 2006) ("'[C]ourts have held that where an estate is solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors' claims must be paid in full, including postpetition [sic] interest, before equity holders may participate in any recovery.' 140 Cong. Rec. H10,752-01, H10,768 (1994).")
4 *See* 28 U.S.C. § 1961.
5 *Onink v. Cardelucci (In re Cardelucci)*, 285 F.3d 1231 (9th Cir. 2002).
6 285 F.3d at 1233.
7 *Id.*
8 *In re Beguelin*, 220 B.R. 94, 100-101 (9th Cir. B.A.P. 1998).
9 *In re Beguelin*, 220 B.R. 94, 100-101 (9th Cir. B.A.P. 1998). This reference appears in the *Cardelucci* case, 285 F.3d 1231 (9th Cir. 2002), at page 1234.
10 *Cardelucci*, 285 F.3d at 1234 (citing Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, § 4-405(a)(8), (1st Sess. 1973)).
11 *Id.* at 1234-35.
12 *Id.* at 1235 (citing *Bursch v. Beardsley & Piper*, 971 F.2d 108, 114 (8th Cir. 1992) ("Once a bankruptcy petition is filed, federal law, not state law, determines a creditor's rights.")).

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"Legal Rate" of Post-Petition Interest for Unsecured Creditors

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Ninth Circuit also highlighted the overriding policy consideration of balancing the equities among the creditors.[13] "By using a uniform interest rate, no single creditor will be eligible for a disproportionate share of any remaining assets to the detriment of other unsecured creditors."[14]

The Bankruptcy Court for the District of Delaware also chose the federal judgment rate, but for very different reasons, in *In re Coram Healthcare Corp.*[15] A unique circumstance impacted the court's decision. At the conclusion of the confirmation hearings on the debtor's first proposed plan of reorganization, the court discovered that the debtor's CEO was also employed as a consultant by the debtor's largest noteholder. The court deemed this employment a conflict of interest, which tainted the debtor's restructuring efforts, and the court therefore denied confirmation of the debtor's first proposed plan.[16] The court later denied confirmation of the debtor's second proposed plan because the conflict had not been cured.[17]

A chapter 11 trustee was appointed, and the trustee submitted a proposed plan of reorganization, as did the equity committee. In considering confirmation of these plans, the appropriate rate of interest to be paid to the class consisting of the debtor's noteholders was a key question. The *Coram Healthcare* court made note of the view espoused in *In re Cardelucci* and other cases, that an allowed claim is the equivalent of a money judgment, and therefore, the federal judgment rate is the appropriate rate to be applied when awarding post-petition interest. However, the court was "not convinced that Congress intended to supplant a party's contractual right to interest in all circumstances under chapter 11."[18] Instead, the court concluded that "the specific facts of each case will determine what rate of interest is 'fair and equitable.'"[19]

In the particular case of *Coram Healthcare*, the court found that the conflict caused by a noteholder, as noted above, created an actual conflict of interest that tainted the debtor's restructuring of its debt, the debtor's negotiation of a plan, and the debtor's ultimate emergence from bankruptcy, all resulting in delay and additional expenses incurred by the debtor. It was further noted that the entire class of noteholders had benefited from this conduct. Therefore, the court determined that "[i]t would be grossly unfair to pay the [n]oteholders [the contractual] default interest during that delay."[20] The court determined that under the circumstances, the federal judgment rate was fair and equitable.[21]

Application of the Contract Rate

The Sixth Circuit issued the leading case advocating for application of the contract rate in its review of *Dow II* on appeal. In *In re Dow Corning Corp.*,[22] the court ruled that in the case of a solvent debtor, "all parties ought to be granted the benefit of their bargains, unless the equities compel a contrary result." The debtor proposed a plan of reorganization that provided for payment in full of the principal amount of all unsecured claims, together with post-petition interest through confirmation at the federal judgment rate of 6.28 percent, compounded annually.[23] The majority of the unsecured commercial debt contracts would have required interest payments at a higher rate, and the unsecured commercial debt holders voted overwhelmingly against the plan, arguing that they would receive less than they would be entitled to in a liquidation, and that they were not being paid the full amount of interest they were owed. Meanwhile, the debtor's two shareholders, both undisputedly junior to the unsecured commercial debt holders, were retaining millions of dollars in equity.[24]

In *Dow II*, the bankruptcy court agreed that the proposed plan was not fair and equitable because junior claims were being paid in advance of full satisfaction of the unsecured commercial debt holders' claims.[25] The court ordered that interest be paid to the unsecured claimants at the applicable contract rate with one caveat: In determining whether the appropriate contract rate was the default rate, no effect was to be given to any contractual provision that purported to define as a default the filing of a voluntary petition for bankruptcy relief (in other words, if the only event of default was the bankruptcy filing, that event alone could not sustain application of the default rate, as opposed to the non-default rate provided for in the contract).[26]

The Sixth Circuit noted that a bankruptcy court's equitable powers "are limited by the role of the bankruptcy court, which is to 'guide the division of a pie that is too small to allow each creditor to get the slice for which he originally contracted.'"[27] "When a debtor is solvent, then, the presumption is that a bankruptcy court's role is merely to enforce the contractual rights of the parties, and the role that equitable principles play in the allocation of competing interest [sic] is significantly reduced."[28] The court determined that § 1129(b)'s fair and equitable standard required that interest be paid not only at the contractual rate, but at the default rate set forth in the applicable contracts.[29] In negotiating for the inclusion of a default rate of interest in a contract, a creditor transfers some of the risk of default from itself to the debtor. "By interpreting the plan as allowing interest only at the non-default rate, the bankruptcy court effectively transferred that risk back to the...creditors."[30]

In a much earlier case involving an individual chapter 11 debtor, the Bankruptcy Court for the Western District of Texas also awarded post-petition interest at the contract rate.[31] The court expressly rejected the arguments cited above in favor of application of the federal judgment rate, and instead held that "when there was a pre-petition contract between the parties that provided for interest, it is that contract rate which should be applied."[32] The court found that whether the contractual non-default or default rate of interest ought to be applied depended upon a balancing of the equities.[33] In balancing the equities, the court found that a particular under-

13 *Id.* (citing *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 165 (1946)).
14 *Id.* (citing *Beguelin*, 220 B.R. at 100 (internal citation omitted)).
15 *In re Coram Healthcare Corp.*, 315 B.R. 321 (Bankr. D. Del. 2004).
16 315 B.R. at 327.
17 *Id.*
18 315 B.R. at 346.
19 *Id.* (citing *In re Dow Corning Corp. (Dow II)*, 244 B.R. 678, 692 (Bankr. E.D. Mich. 1999)).
20 *Id.* at 347.
21 *Id.*
22 *In re Dow Corning Corp.*, 456 F.3d at 671.
23 *Id.* at 671-72.
24 *Id.* at 672.
25 *Id.* at 672 (citing *Dow II*, 244 B.R. at 695-96).
26 *Id.* at 673 (citing *Dow II*, 244 B.R. at 696).
27 456 F.3d at 677-78.
28 *Id.* at 679.
29 *Id.*
30 *Id.*
31 *See In re Schoeneberg*, 156 B.R. 963 (Bankr. W.D. Tex. 1993).
32 *Id.* at 972.
33 *Id.* (quoting *Vanston*, 329 U.S. at 165 ("[I]t is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor.")).

secured creditor whose claim made up the vast bulk of unsecured claims was the "precipitating factor" for the filing of the bankruptcy case, and that said creditor's tactics, while legal, were not necessarily equitable.[34] The court awarded post-petition interest at the nondefault contractual rate.[35]

Appropriate Interpretation of the "Legal Rate" of Interest

The most fair and equitable interpretation of "legal rate" of interest is one that applies the contract rate of interest, if any, and depending on the balancing of the equities of a particular case, the default rate provided for in a given contract. While at least one court has expressed concern that this interpretation would allow for various creditors within a single bankruptcy to receive post-petition interest at varying rates,[36] there is nothing unfair or inequitable inherent in such an outcome. Each creditor has negotiated the particular terms of its contract with the debtor at arm's length and before the petition filing. It is not the role of the bankruptcy court to renegotiate and reshape the terms of a pre-petition contract which is to remain in full force and effect through confirmation. Rather, it is the role of the court to perform equity consistent with the particular facts and circumstances that are laid before the court.

Application of the contract rate of interest, while also being sure to balance the equities of the case in order to determine whether the non-default or default rate ought to apply, allows a bankruptcy court to honor the original agreements bargained for by the debtor and its creditors while also encouraging good faith and fair dealing by and between the parties, so long as the specter of losing the benefit of a default rate for bad behavior remains a real threat. In effect, to allow a debtor to make interest payments at the federal judgment rate would, in nearly every case, result in a windfall for the debtor (and its equity-holders), who would have the benefit of a lower rate of interest than that which it had originally agreed to contractually. At least one court has noted the underlying policy of the Code to avoid producing a windfall for the debtor.[37] Further, to lock bankruptcy courts into application of only the federal judgment rate would limit the use of judicial discretion to both prevent harm to creditors and windfalls to debtors. "Legal rate" can and does encompass whatever the applicable legal rate is, depending on the nature of the claim—be it a state statutorily specified rate where the claim arises out of a state court judgment, the federal judgment rate if the claim does in fact arise out of a federal court judgment or the contract rate (unless, of course, it is usurious) where the claim arises out of a contract between the debtor and a given creditor. ■

34 *See id.* at 973.
35 *Id.*
36 *See In re Melenzyer*, 143 B.R. 829, 832 (Bankr. W.D. Tex. 1992).
37 *See In re Anderson Carter*, 220 B.R. 411, 416-17 (Bankr. D. N.M. 1998).

United States Court of Appeals
For the First Circuit

No. 14-2058

IN RE: CARRIE D. LAWSON,

Debtor

SAUER INCORPORATED, d/b/a Sauer Southeast,

Appellant,

v.

CARRIE D. LAWSON,

Appellee.

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF RHODE ISLAND

[Hon. Diane Finkle, U.S. Bankruptcy Judge]

Before

Lynch, Thompson, and Kayatta,
Circuit Judges.

Michael J. Jacobs and LaPlante Sowa Goldman, on brief for appellant.

Christopher M. Lefebvre, with whom Claude Lefebvre, Christoper Lefebvre, P.C., John Boyajian, and Boyajian, Harrington, Richardson & Furness were on brief, for appellee.

July 1, 2015

LYNCH, Circuit Judge. Sauer Incorporated ("Sauer") filed an adversary proceeding objecting to the discharge of a debt owed by Carrie Lawson ("Ms. Lawson") that she allegedly obtained as part of a fraudulent scheme to prevent Sauer from collecting a previous judgment from her father, James Lawson. See 11 U.S.C. §§ 523(a)(2)(A), 523(a)(6). The bankruptcy court dismissed for failure to state a claim on the ground that a debt for value "obtained by . . . actual fraud" under § 523(a)(2)(A) is limited to debts for value obtained through fraudulent misrepresentations. The court felt First Circuit precedent in the line of Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997), required such a conclusion. See Sauer, Inc. v. Lawson (In re Lawson), 505 B.R. 117, 125-26 (Bankr. D.R.I. 2014) (citing McCrory v. Spigel (In re Spigel), 260 F.3d 27, 32 (1st Cir. 2001); Palmacci, 121 F.3d 781); see also id. (citing Field v. Mans, 516 U.S. 59 (1995)).

On direct appeal, we are asked to resolve this narrow but significant issue of whether a debt that is not dischargeable in Chapter 13 bankruptcy as a debt for money or property "obtained by . . . actual fraud" extends beyond debts incurred through fraudulent misrepresentations to also include debts incurred as a result of knowingly accepting a fraudulent conveyance that the transferee knew was intended to hinder the transferor's creditors.

See 11 U.S.C. § 523(a)(2)(A). We join the Seventh Circuit in concluding that it does. See McClellan v. Cantrell, 217 F.3d 890 (7th Cir. 2000).[1]

Having adopted this new standard, we vacate and remand for further proceedings consistent with this opinion. We decline to reach the issue of the adequacy of Sauer's pleadings of actual fraud under Rule 9(b), and the possibility of amendment if inadequate. Because we have adopted a new standard, the bankruptcy court should address these issues in the first instance. Cf. N. Am. Catholic Educ. Programming Found., Inc. v. Cardinale, 567 F.3d 8, 16-18 (1st Cir. 2009) (Boudin, J.).

I.

We recount the facts as alleged in Sauer's First Amended Complaint, accepting them as true and drawing "all reasonable inferences" in Sauer's favor. See Ruivo v. Wells Fargo Bank, N.A., 766 F.3d 87, 90 (1st Cir. 2014). In brief, Sauer alleges that Ms. Lawson incurred the debt at issue by knowingly receiving a fraudulent conveyance from her father, James, that was designed to

[1] We are aware the Fifth Circuit, in a post-argument decision, has disagreed with McClellan and our analysis here. See Husky Int'l Elec., Inc. v. Ritz (In re Ritz), -- F.3d --, 2015 WL 3372812 (5th Cir. May 22, 2015).

prevent Sauer from collecting a judgment against him. The details are as follows.

In January 2007, Sauer sued James in Providence Superior Court based on their previous business dealings. Three years later, on February 5, 2010, the Superior Court found those transactions to be fraudulent, and awarded Sauer a judgment against James in the amount of $168,351.59, including punitive damages.

Just before the judgment was entered, Ms. Lawson had formed a shell entity, Commercial Construction M&C, LLC ("Commercial Construction").[2] Upon entry of judgment, James transferred $100,150 to Commercial Construction, allegedly to impede Sauer's collection. Commercial Construction is owned by Ms. Lawson, but controlled by James.[3]

Ms. Lawson then transferred $80,000 of the $100,150 from Commercial Construction to herself sometime over the course of the following year, from February 2010 through early 2011. In March 2011, James filed for Chapter 13 bankruptcy.

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[2] Although the complaint does not allege when Ms. Lawson formed Commercial Construction, Ms. Lawson's affidavit, which she appended to her motion to dismiss Sauer's First Amended Complaint, indicates that she formed the entity in January 2010.

[3] The present ownership of Commercial Construction is a matter of some dispute, but it does not affect our analysis.

Pursuant to the Rhode Island Uniform Fraudulent Transfer Act, R.I. Gen. Laws § 6-16-1 et seq. ("UFTA"), Sauer traced portions of its original judgment against James first to Commercial Construction, and then to Ms. Lawson. The Providence Superior Court found these transfers to be fraudulent under the UFTA, and issued executions against both Commercial Construction and Ms. Lawson for the full amounts transferred ($100,150 and $80,000, respectively). The latter judgment entered against Ms. Lawson is the debt at issue.

Ms. Lawson filed for Chapter 13 bankruptcy the same month that the Providence Superior Court issued the execution against her, in March 2013. Sauer initiated this adversary proceeding in June 2013, objecting to the discharge of this debt under § 523(a)(2)(A) as being for money "obtained by . . . actual fraud."[4] In particular, Sauer alleged that because Ms. Lawson "knowingly receiv[ed]" the fraudulent transfer and acted in a "willful and malicious" manner toward Sauer, her acceptance of the fraudulent conveyance constitutes actual, not merely constructive, fraud.[5]

[4] Sauer also objected to discharge under § 523(a)(6), but the bankruptcy court correctly held that this provision does not bar Chapter 13 discharge. Sauer, 505 B.R. at 119 n.4; see 11 U.S.C. § 1328(a)(2).

[5] We do not address the adequacy of this pleading under the heightened pleading standard of Rule 9(b), but assume its adequacy

The bankruptcy court dismissed Sauer's adversary proceeding. The court reasoned that it was constrained by First Circuit and Supreme Court precedent to find that a misrepresentation is a required element of "actual fraud" under § 523(a)(2)(A). See Sauer, 505 B.R. at 118, 125-26 (citing Field, 516 U.S. 59; Spigel, 260 F.3d at 32). Because Sauer concededly could not allege that Ms. Lawson had made a misrepresentation, Sauer could not establish that § 523(a)(2)(A) barred discharge of Ms. Lawson's debt. See id. at 126.

Sauer appealed to the Bankruptcy Appellate Panel and, shortly thereafter, petitioned for direct appeal to the First Circuit. See 28 U.S.C. § 158(d)(2). The Panel granted certification on the ground that the order "involves a matter of public importance," 28 U.S.C. § 158(d)(2)(A)(i), and agreeing, we granted authorization.

II.

The sole issue on appeal is whether the bankruptcy court erred in concluding that "a misrepresentation by a debtor to a creditor is an essential element of establishing a basis for the nondischarge of a debt under § 523(a)(2)(A)." Sauer, 505 B.R. at

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for purposes of resolving the appeal. Cf. N. Am. Catholic Educ., 567 F.3d at 16.

118. This is a question of law, which we review de novo. See N. Am. Catholic Educ., 567 F.3d at 12; United States v. Nippon Paper Indus. Co., 109 F.3d 1, 3 (1st Cir. 1997).

A. The Fraud Exception of § 523(a)(2)(A)

The Bankruptcy Code aims to strike a balance between providing debtors with a fresh start by discharging debts upon plan confirmation, and avoiding abuse of the system. See Spigel, 260 F.3d at 31-32. To this end, the Code exempts from discharge certain types of debt in an attempt to "limit[] th[e] opportunity [for discharge] to the 'honest but unfortunate debtor.'" Id. at 32 (second and third alteration in original) (quoting Brown v. Felsen, 442 U.S. 127, 128 (1979)). Such exceptions are "narrowly construed . . . and the claimant must show that its claim comes squarely within an [enumerated] exception." Id. (first alteration in original) (quoting Century 21 Balfour Real Estate v. Menna (In re Menna), 16 F.3d 7, 9 (1st Cir. 1994)).

This case concerns an exemption to Chapter 13 discharge. Although "discharge under Chapter 13 'is broader than the discharge received in any other chapter,'" Chapter 13 still "restricts or prohibits entirely the discharge of certain types of debts." United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260, 268 (2010) (quoting 8 Collier on Bankruptcy ¶ 1328.01 (rev. 15th ed.

2008)). As relevant here, Chapter 13 does not discharge any debt "for money . . . to the extent obtained by . . . false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A) (emphasis added); id. § 1328(a)(2) (making § 523(a)(2)(A) expressly applicable to Chapter 13).

Although many courts have "assume[d] that fraud [under this provision] equals misrepresentation," McClellan, 217 F.3d at 892-93 (collecting cases), it remains an open question in this circuit whether "actual fraud" includes fraud effected by means other than fraudulent misrepresentation, such as through schemes of fraudulent conveyance, Spigel, 260 F.3d at 32-33 n.7 (expressly declining to reach the issue).[6]

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[6] This surprising gap has an explanation:

Until 1970, the courts tasked with enforcing a creditor's claim also determined whether the judgment thereby rendered was nondischargeable under the fraud exception. See Brown, 442 U.S. at 129-30 (citing Section 17 of the former Bankruptcy Act) ("Typically, that court was a state court."). This proved problematic: creditors were frequently successful in obtaining nondischargeable default judgments in state courts under the exception. Id. at 135-36. To avoid creditor abuse, Congress amended the statute to require creditors seeking to bar discharge under the fraud exception to file directly with the bankruptcy court. See id. But in the cases since, we did not reach the issue of whether "actual fraud" is limited to fraud effected by misrepresentation because misrepresentation was the only type of fraud charged. See McClellan, 217 F.3d at 892-93 (collecting cases); see, e.g., Field, 516 U.S. at 70; Palmacci, 121 F.3d 781; see also, e.g., Anastas v. Am. Sav. Bank (In re Anastas), 94 F.3d 1280, 1285 (9th Cir. 1996) (finding an "implied representation of

an intent" to repay a credit card charge (emphasis added)); Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert), 141 F.3d 277, 281 (6th Cir. 1998) (same); AT&T Universal Card Servs. v. Mercer (In re Mercer), 246 F.3d 391, 403 (5th Cir. 2001) (en banc) (noting that implying misrepresentation under the Palmacci test is "appropriate for determining card-dischargeability because . . . card-use lends itself to that analysis").

Even so, Ms. Lawson argues -- and the bankruptcy court found -- that our inquiry is foreclosed by controlling Supreme Court and First Circuit precedent in Field v. Mans, 516 U.S. 59 (1995), and In re Spigel, 260 F.3d 27 (1st Cir. 2001). But these cases are inapposite.

Field did not address whether "actual fraud" is limited to fraud based on fraudulent misrepresentation. Field, 516 U.S. at 61. Rather, the Court there addressed the requirements when the actual fraud alleged was fraudulent misrepresentation. See id. (addressing the type of reliance required). At no point does the Supreme Court state or even consider that "actual fraud" could be limited to fraudulent misrepresentation. To the contrary, the Court directs us to rely upon the Second Restatement of Torts which, as will be discussed, identifies multiple forms of "fraud." See Field, 516 U.S. at 70; Restatement (Second) of Torts § 871 cmts., index (1977); cf. In re Mercer, 246 F.3d at 403 (recognizing that the Restatement "does not define 'fraud'" but discusses particular forms thereof).

Spigel, far from foreclosing our inquiry, expressly left it open. See Spigel, 260 F.3d at 32-33 n.7. That case did not concern whether a misrepresentation was required, but the relationship between the "fraudulent conduct" and the debt. Id. at 32-35 (holding that the debt must be a "direct result" of fraudulent conduct intended to swindle the relevant creditor). Not only did we decline to reach the question of the scope of "actual fraud," we expressed doubt that the Palmacci test for debt obtained through fraudulent misrepresentations was the "exclusive test" for nondischargeability under § 523(a)(2)(A). Id. at 32-33 n.7 (citing McClellan, 217 F.3d at 892-95); cf. In re Mercer, 246 F.3d at 403 & n.3 (noting disagreement).

The Supreme Court has directed us that in construing the meaning of "actual fraud" under this provision, we are to rely on the common law "concept of 'actual fraud' as it was understood in 1978 when that language was added to § 523(a)(2)(A)." Field, 516 U.S. at 70. "Then, as now, the most widely accepted distillation of the common law of torts was the Restatement (Second) of Torts (1976), published shortly before Congress passed the Act." Id. Accordingly, we look to the same Restatement as relied upon in Field.

That Restatement recognizes several types of "fraud," including both fraudulent misrepresentations and "fraudulent interference with [property rights]," a tort that is broader than misrepresentation itself. See Restatement (Second) of Torts, index, "Fraud" (1977); see also id. § 871 ("One 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."). The comments to the relevant Restatement provision, § 871, make clear that this includes fraudulent conveyance, like that alleged here. Id. § 871 cmt. a ("[T]he rule applies when title to land has been obtained by fraud . . . and has been transferred to one other than a bona fide purchaser, in

which case, until its sale by the transferee, the original owner's sole redress against the transferee is by an action seeking its recovery."). That is, the common law concept of "fraud" as distilled by the Restatement to which the Court directs us extends beyond fraudulent misrepresentations to at least include fraudulent conveyances. See id.; see also id. § 871 cmt. e.

This comports with other examples of the common understanding of "fraud." See McClellan, 217 F.3d at 893 ("No learned inquiry into the history of fraud is necessary to establish that [fraud] is not limited to misrepresentations and misleading omissions."). As the leading treatise on bankruptcy explains, "[a]ctual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another . . . ." 4 Collier on Bankruptcy ¶ 523.08[1][e] (A.N. Resnick & H.J. Sommer, eds., 16th ed. 2015). This "generic term" has frequently been used to "embrace[] all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth." McClellan, 217 F.3d at 893 (quoting Stapleton v. Holt, 250 P.2d 451, 453-54 (Okla. 1952)). And, as relevant here, "when a debtor transfers property to a third party without adequate

consideration" to hinder her creditors, this "is deemed fraud on [her] creditors." Id. at 894 (collecting cases); see also, e.g., R.I. UFTA, R.I. Gen. Laws § 6-16-1 et seq. (providing remedies for fraudulent conveyances); Spaziano v. Spaziano, 410 A.2d 113, 114-15 (R.I. 1980); Jorden v. Ball, 258 N.E.2d 736, 737 (Mass. 1970).[7]

We adopt this common law understanding and hold that "actual fraud" under § 523(a)(2)(A) is not limited to fraud effected by misrepresentation. See Field, 516 U.S. at 73-74 (applying the "established practice of finding Congress's meaning in the generally shared common law" to § 523(a)(2)(A)). Rather, we hold that "actual fraud" includes fraudulent conveyances that are "intended . . . to hinder [the relevant] creditors." McClellan, 217 F.3d at 894. Consistent with our precedents, our holding is limited to cases of actual, as opposed to merely constructive, fraud. See Spigel, 260 F.3d at 32 ("[W]e have said

[7] Even the early Bankruptcy Acts characterized "fraudulent conveyances" as a form of "fraud." See, e.g., Bankruptcy Act of 1867, ch. 176, § 35, 14 Stat. 517, 534 ("[I]f such sale, assignment, transfer, or conveyance [made to evade attachment in bankruptcy] is not made in the usual and ordinary course of business of the debtor, the fact shall be prima facie evidence of fraud." (emphasis added)); Bankruptcy Act of 1898, ch. 541, § 29(b), 30 Stat. 544, 554 ("A person shall be punished . . . upon conviction of the offense of having knowingly and fraudulently . . . received any material amount of property from a bankrupt after the filing of the petition, with the intent to defeat this Act . . . ." (emphasis added)).

that the statutory language does not 'remotely suggest that nondischargeability attaches to any claim other than one which arises as a direct result of the debtor's [fraudulent conduct].'" (quoting Century 21, 16 F.3d at 10)); Palmacci, 121 F.3d at 788 (emphasizing that § 523(a)(2)(A) "requires a showing of actual or positive fraud, not merely fraud implied by law" (quoting Anastas v. Am. Sav. Bank (In re Anastas), 94 F.3d 1280, 1286 & n.3 (9th Cir. 1996))). That is, the debtor-transferee must herself be "guilty of intent to defraud" and not merely be the passive recipient of a fraudulent conveyance. See McClellan, 217 F.3d at 894 (noting that fraud is "constructive if the only evidence of it is the inadequacy of the consideration"). Such intent may be inferred from her acceptance of a transfer that she knew was made with the purpose of hindering the transferor's creditor(s), but it may not be implied as a matter of law. See Neal v. Clark, 95 U.S. 704, 707-09 (1877) (distinguishing "actual fraud" from "constructive fraud" which "may exist without the imputation of bad faith or immorality").

Our reading is confirmed by the structure of the text and the legislative history. "'[A]ctual fraud' [was] added as a ground for exception from discharge" under § 523(a)(2)(A) in 1978. S. Rep. No. 95-989, at 78 (1978); H.R. Rep. No. 95-595, at 364

(1977). That provision now "explicitly lists both 'actual fraud' and 'false representations' as grounds for denying a discharge." Spigel, 260 F.3d at 33 n.7. We agree with the Seventh Circuit that this distinction must have meaning, and that the most obvious meaning is the one that comports with common law understanding: "actual fraud is broader than misrepresentation." McClellan, 217 F.3d at 893.

Indeed, this is confirmed by the Legislative Statements concerning the change, which reveal that the drafters specifically contemplated not only a broader reading of "actual fraud," but that debt incurred through (actually) fraudulent conveyances would be barred from discharge under § 523(a)(2)(A). The Legislative Statement concerning § 523(a)(2)(A) is express that the addition "is intended to codify current case law, [like] Neal v. Clark, 95 U.S. 704 (18[7]7)." See 11 U.S.C. § 523, Legislative Statements (explaining that § 523(a)(2)(A) is limited to "actual or positive fraud rather than fraud implied by law"). That case, Neal v. Clark, presumed that the Bankruptcy Code exempted from discharge as a "debt created by . . . fraud" at least some debts incurred through receipt of a fraudulent conveyance. See Neal, 95 U.S. at 706-09 (holding that debt created through receipt of a fraudulent conveyance must be actual fraud, not merely constructive fraud, to

bar from discharge in bankruptcy); Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517, 533; cf. id. ch. 176, § 35, 14 Stat. at 534.[8]

"The history of the fraud exception reinforces our reading of § 523(a)(2)(A)." Cohen v. de la Cruz, 523 U.S. 213, 221 (1998). The bankruptcy practices at issue in Neal and codified by § 523(a)(2)(A) concerned Section 33 of the Bankruptcy Act of 1867, which barred debts "created by . . . fraud." Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. at 533. The Bankruptcy Act of 1898 similarly prohibited discharge of 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" under Section 17(a)(2).[9]

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[8] The Supreme Court in Neal was construing the term "fraud" as it appeared in Section 33 of the Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. at 533. That provision provided in relevant part:

> [N]o debt created by the fraud or embezzlement of the bankrupt, or by his defalcation as a public officer, or while acting in any fiduciary character, shall be discharged under this act . . . .

Id. These various bars to discharge have been expanded upon and now appear as enumerated exceptions.

[9] Section 17(a)(4) of the Bankruptcy Act of 1898 also prohibited discharge of debts "created by [debtor's] fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." 30 Stat. at 550-51. This appears to be the precursor to § 523(a)(4) of the modern Bankruptcy Code, which prohibits discharge (including Chapter 13 discharge) of debts "for fraud or defalcation while acting in a fiduciary

Bankruptcy Act of 1898, ch. 541, § 17(a)(2), 30 Stat. 544, 550; Cohen, 523 U.S. at 221. Subsequent amendments retained the "willful and malicious injuries" language until 1970, when "willful and malicious conversion of the property of another" was substituted. See 11 U.S.C. § 35(a)(2) (1976); Act of Oct. 19, 1970, Pub. L. No. 91-467, sec. 5-6, §§ 17(a)(2), 17(a)(8), 84 Stat. 990, 992. This substituted language preserved the breadth of the fraud exception articulated in Section 17(a)(2), the predecessor of § 523(a)(2)(A).[10] Cf. Black's Law Dictionary 406 (10th ed. 2014) (defining "conversion" as "an act or series of acts of willful interference, without lawful justification, with an item of property in a manner inconsistent with another's right, whereby that other person is deprived of the use and possession of the property").

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capacity, embezzlement, or larceny." See 11 U.S.C. §§ 523(a)(4), 1328(a)(2).

[10] This "willful and malicious conversion" is distinct from the exception to discharge now codified at § 523(a)(6) for "willful and malicious injury by the debtor to another entity or to the property of another entity." See 11 U.S.C. § 35(a)(8) (1976) (barring discharge of debts that "are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision" (emphasis added)).

We "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." Cohen, 523 U.S. at 221 (internal quotation marks and citation omitted). The alteration of this language in 1978 "in no way signals an intention to narrow the established scope of the fraud exception along the lines suggested by" Ms. Lawson, nor have the parties identified anything in the legislative history that would suggest such a change. See id. at 221-22. Rather, "[§] 523(a)(2)(A) continues the tradition" of "affording relief only to an 'honest but unfortunate debtor'" by excepting from discharge any debt obtained by "'false pretenses, a false representation, or actual fraud.'" See id. at 217-18 (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991); 11 U.S.C. § 523(a)(2)(A)). We hold that the fraud exception to discharge codified at § 523(a)(2)(A) continues to bar from discharge debts incurred through knowing and intentional receipt of fraudulent conveyances as it has since 1867. Cf. 43 R.E. Williams, Am. Jur. Proof of Facts § 13 (3d ed. 2015) ("[T]here is a great deal of continuity between the former Bankruptcy Act and the 1978 Bankruptcy Code, and between common-law fraud and

nondischargeability under Code § 523(a)(2). Even the language of the statute is continuous.").[11]

B. Declining to "Shoehorn" Fraudulent Conveyance into § 523(a)(6)

Ms. Lawson next argues that because her bankruptcy case arises under the more forgiving provisions of Chapter 13, not Chapter 7, we should avoid construing § 523(a)(2)(A) to "extend" beyond fraud effected by misrepresentation.

Her argument, charitably read, begins with the assertion that Ms. Lawson's alleged conduct more readily falls within the nondischargeability provision of 11 U.S.C. § 523(a)(6).[12] Cf. McClellan, 217 F.3d at 896 (Ripple, J., concurring). Because that provision bars discharge of any debt "for willful and malicious

[11] This treatise is another example of one that appears to assume, as many cases do, that § 523(a)(2)(A) requires a misrepresentation. It does not directly address the distinction between "false pretenses, [and] false representation[s]" and "actual fraud," or discuss the McClellan standard except in passing. See, e.g., id. § 13; but see id. (collecting cases following McClellan without expressly identifying the issue).

[12] To the extent Ms. Lawson argues that we should read the same provision differently depending on the type of bankruptcy proceeding, her argument is a nonstarter. Chapter 13 provides a broader discharge than Chapter 7 because fewer exemptions have been made applicable, not because those that are should be construed more narrowly. See 11 U.S.C. § 1328(a)(2) (making § 523(a)(2) expressly applicable as a reason to bar discharge of certain debts in a Chapter 13 proceeding while rendering inapplicable other reasons for denying discharge under § 523(a)).

injury by the debtor to another entity," 11 U.S.C. § 523(a)(6), Ms. Lawson argues that it "provides a far more direct avenue for dealing with a situation such as [this]" where the debtor allegedly accepted a fraudulent conveyance specifically to impede the injured party's attempt to collect from another. McClellan, 217 F.3d at 896 (Ripple, J., concurring). As Judge Ripple observed, § 523(a)(6) has been used to prevent discharge of exactly this sort. See id. at 898 (discussing Murray v. Bammer (In re Bammer), 131 F.3d 788 (9th Cir. 1997) (en banc)); but see id. at 899 n.1 (conceding that the Ninth Circuit later limited its holding where the fraudulent transferee filed for bankruptcy before the plaintiff, who did not have a security interest, obtained a judgment against the transferee for the transfer).

Against this backdrop, Ms. Lawson argues that the distinction between Chapter 13 and Chapter 7 discharge provides a reason to follow Judge Ripple's suggested construction, and to find the alleged conduct to be covered under § 523(a)(6), not § 523(a)(2). This is because Chapter 13, which provides for a broader discharge than Chapter 7, does not bar the discharge of debts specified in § 523(a)(6), except in limited circumstances

not relevant here.[13] See 11 U.S.C. § 1328(a)(2); United Student Aid Funds, 559 U.S. at 268 ("[D]ischarge under Chapter 13 'is broader than the discharge received in any other chapter.'" (quoting 8 Collier on Bankruptcy ¶ 1328.01 (rev. 15th ed. 2008))).

This argument is foreclosed by the statutory history of § 523(a)(6), "the historical pedigree of the fraud exception [in § 523(a)(2)(A)], and the general policy underlying the exceptions to discharge." See Cohen, 523 U.S. at 223. We begin with the history of the proposed alternative, § 523(a)(6).

The discharge of debts for "willful and malicious injuries to the person or property of another" was originally included in the fraud exception of Section 17(a)(2). That changed in 1970, when the provision that is now codified in § 523(a)(6) was added to the statute as Section 17(a)(8). See Act of Oct. 19, 1970, sec. 5-6, §§ 17(a)(2), 17(a)(8), 84 Stat. at 992 (formerly codified at 11 U.S.C. § 35(a)(8) (1976)).

However, that amendment did not completely remove all "willful and malicious injuries" to a creditor's property from the scope of the fraud exception in Section 17(a)(2). Rather, Section 17(a)(2) continued to bar discharge of liabilities "for willful

[13] See 11 U.S.C. § 1328(b), (c) (providing for a hardship discharge except for "any debt" specified in § 523(a)).

and malicious conversion of the property of another," like willful and malicious receipt of a fraudulent conveyance. See Black's Law Dictionary 406 ("[C]onversion . . . . include[s] such acts as taking possession, refusing to give up on demand, disposing of the goods to a third person, or destroying them." (quoting W. Geldart, Introduction to English Law 143 (D.C.M. Yardley ed., 9th ed. 1984))); cf. Neal, 95 U.S. 704. By contrast, the new provision that preceded § 523(a)(6) barred discharge of debts that "are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision." See 11 U.S.C. § 35(a)(8) (1976) (emphasis added).

The notes to the re-codification of these provisions under the Bankruptcy Reform Act of 1978 do not clearly indicate an intention to alter their relative scope with respect to the means by which fraud may be perpetrated. "[A]ctual fraud" was added to § 523(a)(2)(A) expressly for the purpose, as discussed, of "codify[ing] current case law" concerning fraud. See 11 U.S.C. § 523, Legislative Statements (citing Neal, 95 U.S. 704 (holding that receipt of a fraudulent conveyance must "involv[e] . . . intentional wrong" to be nondischargeable)). Although there is some ambiguity about which "willful and malicious conversion[s]"

are subsumed under § 523(a)(6) rather than § 523(a)(2),[14] there is not "a clear indication that Congress intended . . . a departure" that would limit the means by which fraud might be perpetrated for purposes of § 523(a)(2)(A). See Cohen, 523 U.S. at 221-22. Accordingly, we decline to find one. See id. (noting that absent such an indication, we should not "read the Bankruptcy Code to erode past bankruptcy practice").

The continued inclusion of (actual) fraudulent conveyance within § 523(a)(2) is consistent with Congress's "conclu[sion] that preventing fraud is more important than letting defrauders start over with a clean slate." McClellan, 217 F.3d at 893 (quoting Mayer v. Spanel Int'l, Ltd. (In re Mayer), 51 F.3d 670, 674 (7th Cir. 1995)); see also Grogan, 498 U.S. at 286-87. This is because it prevents Chapter 13, as well as Chapter 7, from becoming "an engine for fraud" by barring from both types of

[14] The Legislative Statements to § 523(a)(6) state that "[t]he phrase 'willful and malicious injury' covers a willful and malicious conversion." But the Legislative Statements do not address the distinction suggested in the previous version of the statute between those "willful and malicious conversion[s]" excepted under the fraud exception of Section 17(a)(2) and those excepted under Section 17(a)(8). Compare 11 U.S.C. § 35(a)(8) (1976) (qualifying the conversions excluded from Section 17(a)(8) as being those conversions covered by the fraud exception), with 11 U.S.C. § 523, Legislative Statements (noting that "'willful and malicious injury' covers a willful and malicious conversion").

discharge debts obtained by fraudulent conveyance. See 11 U.S.C. § 1328; cf. McClellan, 217 F.3d at 893. Were we to hold otherwise, and accept Ms. Lawson's argument that such conduct is covered by § 523(a)(6) instead of § 523(a)(2), then the perpetrators of the "two-step routine" alleged could make "as blatant an abuse of the Bankruptcy Code as we can imagine" simply by having the second debtor file for Chapter 13, rather than Chapter 7, bankruptcy. Cf. McClellan, 217 F.3d at 893.

Chapter 13, it is true, provides a broader "fresh start" than Chapter 7 because the debtor attempts to make good on some of her obligations. But, as the Supreme Court has repeatedly observed in "addressing different issues surrounding the scope of [this] exception," we think it "unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud" provided such perpetrators are especially clever, avoid all misrepresentations, and file under Chapter 13. See Cohen, 523 U.S. at 223 (alteration in original) (quoting Grogan, 498 U.S. at 287). Far from supporting Ms. Lawson's argument that we should read fraudulent conveyances to be proscribed by § 523(a)(6), and not § 523(a)(2)(A), the distinction between Chapter 13 and Chapter 7 discharge confirms our construction.

C. Narrowness

Finally, there may be some concern that finding that the Palmacci test is not the exclusive test for "actual fraud" under § 523(a)(2)(A) untethers the "actual fraud" requirement from a narrow, principled approach to its construction. Cf. Blacksmith Invs., LLC v. Woodford (In re Woodford), 403 B.R. 177, 188-89 (Bankr. D. Mass. 2009); 43 R.E. Williams Am. Jur. Proof of Facts § 21 (3d ed. 2015) (discussing the difficulties in applying § 523(a)(2)(A) to debts created by credit card fraud). The Palmacci test provides a narrow construction with clear elements.[15] If, as the Seventh Circuit suggests, "[n]o definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated," then how is the fraud exception to be narrowly construed? Cf. McClellan, 217 F.3d at 893 (quoting Stapleton, 250 P.2d at 453-54).

[15] The Palmacci test applies the "traditional common law rule" for fraudulent misrepresentation. See Palmacci, 121 F.3d at 786. Under it, a creditor objecting to a debt "obtained by . . . actual fraud" effected through a misrepresentation must show that:

> 1) the debtor made a knowingly false representation or one made in reckless disregard of the truth, 2) the debtor intended to deceive, 3) the debtor intended to induce the creditor to rely upon the false statement, 4) the creditor actually relied upon the misrepresentation,

We need not and do not decide that question today. We hold only that the "actual fraud" exception to discharge under § 523(a)(2)(A) includes knowing receipt of a fraudulent conveyance where such receipt constitutes actual (as opposed to constructive) fraud. Cf. McClellan, 217 F.3d at 894 (emphasizing the requirement that the transferee have intended to thwart the transferor's creditor); Neal, 95 U.S. at 707 (distinguishing between those cases where receipt of fraudulent conveyance constitutes "actual fraud" owing to recipient's intent and those where receipt is merely "constructive fraud" as implied by law). But we make two observations.

First, we observe that, while there are other ways to give meaning to the distinction between "actual fraud" and "false representations" under § 523(a)(2)(A), they are not the most narrow available, nor are they consistent with the fraud exception's history. Cf., e.g., Field, 516 U.S. at 70 n.8 (declining to decide if a different type of reliance is required under "false pretense" or "false representation"); Mayer v. Spanel Int'l, Ltd. (In re

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> 5) the creditor's reliance was justifiable, and 6) the reliance upon the false statement caused damage.

Spigel, 260 F.3d at 32 & n.6 (citing Palmacci, 121 F.3d at 786; Field, 516 U.S. at 70-71).

Mayer), 51 F.3d 670, 674 (7th Cir. 1995) (Easterbrook, J.) (suggesting without deciding that "false pretense" or "false representation" may carry a different scienter requirement); Restatement (Second) of Torts §§ 525 et seq., 550 et seq. (1977) (discussing related torts of fraudulent misrepresentation, nondisclosure, negligent misrepresentation, and innocent misrepresentation). Rather, reading "false pretenses, false representations, and actual fraud" to be limited, roughly, to mean "fraudulent misrepresentation and other actual frauds" would provide the most consistent and narrow reading of § 523(a)(2)(A) by barring from discharge only those debts that "'arise[] as a direct result of the debtor's [fraudulent conduct].'" Spigel, 260 F.3d at 32 (quoting Century 21, 16 F.3d at 10); cf. Mayer, 51 F.3d at 674 (lamenting that courts have consistently read a culpable intent requirement into the "false pretenses" and "false representation[s]" language of the fraud exception). We need not decide today whether to adopt such a reading. Our point is only that our construction, far from broadening the fraud exception, permits the most narrow construction possible.

Second, we observe that the dangers to narrowness of reading "actual fraud" somewhat expansively -- and the abuse by creditors it might engender -- is protected against by the

provision of fees and costs to the debtor where "a creditor requests a determination of dischargeability" under § 523(a)(2) that is ultimately discharged and "the court finds that the position of the creditor was not substantially justified." 11 U.S.C. § 523(d). Indeed, this is the only exception to discharge under § 523 for which such debtor protection is afforded, and it is afforded specifically to discourage creditors from such abuse. See S. Rep. No. 95-989, at 80 (noting that fees are available "if the court finds that the proceeding was frivolous or not brought by its creditor in good faith").

III.

Finally, Ms. Lawson argues in the alternative that Sauer's complaint fails under our newly adopted standard because Sauer has alleged only constructive fraud. See McClellan, 217 F.3d at 894. But while our holding is emphatically limited to cases of actual, as opposed to merely constructive, fraud, and the heightened pleading requirements for fraud remain applicable, we decline to reach the issue. See Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009. Compare McClellan, 217 F.3d at 894 (noting that fraud is "constructive if the only evidence of it is the inadequacy of the consideration"), with Bell Atl. Corp. v. Twombly, 550 U.S. 544, 556 (2007) (requiring under notice pleading standards factual

allegations "suggestive enough" to make a claim for "conspiracy plausible"). Cf. N. Am. Catholic Educ., 567 F.3d at 16 (refusing "to assume that no amendment could rescue certain of the claims").

The bankruptcy court and the parties proceeded on the apparent understanding that the principal obstacle to Sauer's suit was Sauer's inability to plead misrepresentation.[16] Accordingly, we leave the issues of the adequacy of Sauer's pleading, and the possibility of amendment, to the bankruptcy court in the first instance. See N. Am. Catholic Educ., 567 F.3d at 16 ("For deficiencies under Rule 9(b), leave to amend is often given, at least for plausible claims."); see also New Eng. Data Servs., Inc. v. Becher, 829 F.2d 286, 292 (1st Cir. 1987) (noting that the policy behind Rule 9(b) -- avoiding groundless claims, damage to a defendant's reputation, and ensuring notice -- must be balanced against "the policy in favor of allowing amendments and trying cases on their merits, and against dismissals which would deny plaintiffs their day in court"); cf. 11 U.S.C. § 523(d) (awarding costs and attorneys' fees for unsuccessful adversary proceedings under § 523(a)(2)(A) that are frivolous or brought in bad faith).

[16] Ms. Lawson does not appear to have pressed the adequacy argument before the bankruptcy court, focusing her energies instead on the failure to allege a misrepresentation under the Palmacci standard.

Accordingly, we vacate the bankruptcy court's grant of Ms. Lawson's motion to dismiss, and remand for further proceedings consistent with this opinion. No costs are awarded.

Litigator's Perspective

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Applying the *Bullock* § 523(a)(4) Defalcation Standard

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In 2013, the U.S. Supreme Court decided *Bullock v. BankChampaign NA*[1] and resolved a circuit split about whether the dischargeability exception set forth in § 523(a)(4) "for ... defalcation while acting in a fiduciary capacity"[2] requires any level of *scienter* and, if so, to what degree.[3] The Supreme Court held that when a fiduciary's conduct "does not involve bad faith, moral turpitude, or other immoral conduct," defalcation still requires "an intentional wrong."[4] Stated differently, defalcation has "a culpable state-of-mind requirement," and one that involves "knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior."[5]

While clarifying the legal standard for defalcation, the Supreme Court provided limited guidance about how the standard should be applied by trial courts. As one court noted, "[s]ince the Supreme Court announced *Bullock*, a number of courts have applied this heightened *mens rea* standard without any consensus about the proper mechanism and process for implementing it."[6] However, the Court did provide some clues in *Bullock* regarding the *scienter* requirement based on its reliance on the criminal law definition of "recklessness" in the Model Penal Code, which bankruptcy courts have used to develop an analytical framework for defalcation cases.

Bankruptcy courts are generally in agreement that the *Bullock* standard has subjective and objective elements, requiring evidence that the debtor was aware that his/her conduct might violate a fiduciary duty or "willfully blind" to a substantial and unjustifiable risk that his/her conduct would violate a fiduciary duty, along with an objective assessment by the court of whether the debtor's conduct involved a "gross deviation from the standard of conduct that a law-abiding person would observe in the [debtor's] situation."[7] This multi-faceted test gives rise to fact-intensive inquiries, situational analyses and a whole host of evidentiary issues for parties litigating defalcation claims in bankruptcy court. It is critical for any attorney who is prosecuting or defending such claims to fully understand the analytical framework and probative evidence of defalcation.

Unpacking and Understanding the *Bullock* Defalcation Standard

In *Bullock*, the Supreme Court defined "defalcation" to include "not only conduct that the fiduciary knows is improper, but also reckless conduct of the kind that the criminal law often treats as the equivalent."[8] The Court referred to the Model Penal Code's definition of "recklessness," which encompasses situations where a fiduciary "consciously disregards (or is willfully blind to) a substantial and unjustifiable risk that his conduct will turn out to violate a fiduciary duty."[9] The Supreme Court also emphasized that a "substantial and unjustifiable risk ... must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, [the fiduciary's] disregard involves *a gross deviation* from the standard of conduct that a law-abiding person would observe in the actor's situation."[10]

In applying the *Bullock* defalcation standard, bankruptcy courts have relied heavily on the Supreme Court's incorporation of the Model Penal Code's criminal recklessness standard.[11] In *Pearl*, the bankruptcy court explained that "*Bullock*'s reference to § 2.02 of the Model Penal Code suggests that the § 523(a)(4) recklessness determination is a hybrid of the subjective and objective."[12] In *Cupit*, the bankruptcy court performed an in-depth analysis of the Model Penal Code to delineate the subjective and objective elements of the criminal-recklessness standard and explain how it applies in the context of civil defalcation claims.[13]

The debtor in *Cupit* was the owner and president of a roofing company that was being sued by a roofing products supplier for nonpayment.[14] After the debtor filed for personal bankruptcy, the supplier brought a complaint to determine the nondischarge-

1 133 S. Ct. 1754 (2013).
2 11 U.S.C. § 523(a)(4).
3 Prior to *Bullock*, courts of appeals had developed three different defalcation standards. *Compare In re Baylis*, 313 F.3d 9, 20 (1st Cir. 2002) ("[D]efalcation requires something close to a showing of extreme recklessness."); and *In re Hyman*, 502 F.3d 61, 68 (2d Cir. 2007) (*accord*), *with In re Uwimana*, 274 F.3d 806, 811 (4th Cir. 2001) (applying negligence standard); *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997) (noting that defalcation includes innocent default of fiduciary); and *In re Lewis*, 97 F.3d 1182, 1186 (9th Cir. 1996) (same), and *with In re Harwood*, 637 F.3d 615, 624 (5th Cir. 2011) (reasoning that defalcation is willful neglect of duty that does not require actual intent, but is "essentially a reckless standard."); *In re Patel*, 565 F.3d 963, 970 (6th Cir. 2009) (applying objective-recklessness standard); and *In re Berman*, 629 F.3d 761, 766 n.3 (7th Cir. 2011) (reasoning that defalcation requires something more than negligence or mistake, but less than fraud).
4 133 S. Ct. 1754, 1759.
5 *Id.* at 1757.
6 *See In re Chidester*, 524 B.R. 656, 661 (W.D. Va. 2015).
7 133 S. Ct. 1754, 1760.
8 *Id.*
9 *Id.* (citing Model Penal Code § 2.02(2)).
10 *Id.* at 1759 (emphasis in original).
11 *See, e.g., In re Cupit*, 514 B.R. 42 (Bankr. D. Colo. 2014); *In re Pearl*, 502 B.R. 429 (Bankr. E.D. Pa. 2013).
12 502 B.R. at 441.
13 514 B.R. at 50-52.
14 514 B.R. at 47.

ability of the debt under § 523(a)(4) based on the debtor's misapplication of funds under the Colorado Mechanic's Lien Trust Fund Statute.[15] Following a trial on the merits, the bankruptcy court determined that the debtor's obligation to the supplier was partially nondischargeable as a "fiduciary's defalcation debt."[16] In reaching that conclusion, the *Cupit* court first noted that the test for criminal recklessness is subjective, while the tort definition is objective.[17] "In criminal law, liability for reckless conduct depends on a finding that the defendant disregards a risk of harm *of which he is aware*."[18] Thus, the court reasoned that to meet *Bullock*'s recklessness standard, there must be evidence that the debtor was subjectively aware that his conduct might violate a fiduciary duty.[19] In other words, "[t]here must be some evidence that the debtor was aware of the fiduciary duty and of the risk that his conduct would violate that duty."[20]

In addition to conscious disregard of a risk, *Bullock* held that defalcation occurs where a debtor is "willfully blind" to a substantial and unjustifiable risk that his/her conduct will turn out to violate a fiduciary duty.[21] The *Cupit* court explained that "willful blindness" is imported from criminal law,[22] and under the Supreme Court's two-part test for willful blindness, a defendant must (1) subjectively believe that there is a high probability that a fact exists and (2) take deliberate actions to avoid learning that fact.[23] As to whether the disregarded risk is "substantial" and "unjustifiable" to establish defalcation under § 523(a)(4), the *Cupit* court explained that "[t]hese attributes are more objective in nature and depend on an assessment of the surrounding circumstances and the nature and purpose of the defendant's conduct."[24] Whether a risk is substantial depends on the likelihood that harm will occur and the magnitude of the potential harm, and whether a risk is unjustifiable depends on the purpose of the conduct relative to the risk.[25]

Translating the criminal standard into the defalcation context, a risk could be justified if there were some possible interest or benefit to the trust beneficiary that outweighs the risk of the misuse of entrusted funds.[26] Finally, whether the defendant's disregard constitutes a "gross deviation" from the standard of conduct that a law-abiding citizen would observe "is essentially a 'value judgment' by the fact-finder as to whether the defendant's conduct 'justifies condemnation.'"[27]

Applying the subjective-recklessness standard to the facts in *Cupit*, the court placed substantial weight on the debtor's testimony that he had no actual knowledge of his fiduciary duties under the trust fund statute or that he was violating those duties.[28] The court rejected the plaintiff's argument that the debtor should have been aware of his duties based on evidence regarding his extensive industry experience, his participation in trade associations and committees, and his work on training curriculum for trade organizations, because it is not an objective standard and there was no indication that any of the debtor's training or experience directly related to the trust fund statute or that it made the debtor aware of his fiduciary duties.[29] However, the court found that the debtor was either willfully blind to or consciously disregarded a risk that he was mishandling trust funds after he was sued by the plaintiff in state court for violating the trust fund statute, because the lawsuit put the debtor on notice that he owed fiduciary duties to material suppliers under the trust fund statute and his conduct from that day forward constituted deliberate action to avoid learning of his duties (*i.e.*, willful blindness).[30]

Turning to the objective analysis, the *Cupit* court found that the debtor's misuse of the trust funds was unjustified because the debtor's purpose for doing so was to improve the financial condition of the debtor's business, not to assist the plaintiff.[31] Furthermore, the court determined that the debtor's awareness of his duties under the trust fund statute after being sued, and the high likelihood that his method of paying the oldest bills first would cause trust funds to be spent on unrelated expenses in violation of the trust fund statute, amounted to a gross deviation from the standard of conduct that a law-abiding contractor would follow.[32] Consequently, the court held that the debt incurred to the plaintiff after the lawsuit was initiated against the debtor was nondischargeable under § 523(a)(4). The *Cupit* analysis has been applied by bankruptcy courts in other districts and provides a helpful roadmap for the defalcation analysis.[33]

Key Takeaways and Evidentiary Issues in Defalcation Cases

Cupit demonstrates that establishing a debtor's awareness of his/her fiduciary obligations is the starting point for the defalcation analysis. As debtors will often claim ignorance and innocent mistakes in violating fiduciary obligations, in the absence of documentary evidence to prove that the debtor was aware of the fiduciary duty and the risk that his/her conduct would violate that duty, cases may turn on whether the plaintiff can sufficiently demonstrate that the debtor's education and experience informed him/her of the fiduciary obligations.

In another case involving a contractor and a trust fund statute, the *Stoughton Lumber Co. v. Sveum* court rejected the debtor's "protestations of innocence" based on his education and experience, combined with evidence that the statute's trust fund requirement was generally known in the industry, to conclude that the debtor was "playing ostrich" and thus engaging in grossly reckless conduct that constituted defalcation.[34] *Cupit* illustrates that proving that a debtor was on notice of his fiduciary obligations increases the likelihood that defalcation will be established on account of willful

15 *Id.*
16 *Id.*
17 *Id.* at 50.
18 *Id.* (emphasis in original).
19 *Id.*
20 *Id.* at 51.
21 514 B.R. at 51.
22 *Id.* (citing Model Penal Code § 2.02(7)).
23 *Id.* at 52 (citing *Global-Tech Appliances Inc. v. SEB S.A.*, 131 S. Ct. 2060, 2070 (2011)).
24 *Id.* at 52 (citing Model Penal Code and Commentaries § 20.02 cmt. 3, at 237-38).
25 *Id.* at 52.
26 *Id.* at 53.
27 *Id.* at 52.
28 *Id.* at 52-53.
29 *Id.* at 53.
30 *Id.*
31 *Id.*
32 *Id.*
33 *See In re Rachel*, 527 B.R. 529 (Bankr. N.D. Ga. 2015); *In re Watterson*, 524 B.R. 445 (Bankr. E.D.N.Y. 2015); and *In re Chidester*, 524 B.R. 656 (Bankr. W.D. Va. 2015) ("This Court agrees with the *Cupit* court's reasoning, and thus, the remainder of this analysis will track that opinion closely.").
34 787 F.3d 1174, 1176-77 (7th Cir. 2015).

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blindness. Depending on the type of fiduciary relationship, such notice could take various forms short of filing a lawsuit, including contractual provisions, sworn affidavits, lien notices, demand letters and litigation with other parties.

Outside of the construction trust fund context, the sophistication of the debtor in a traditional fiduciary role might be significant. For instance, a lawyer who sells his/her services as an escrow agent might be charged with greater knowledge of his/her fiduciary obligations than a layperson serving as a trustee for a family trust, like the debtor in *Bullock*.[35] Some cases may require expert witness testimony to demonstrate the existence of a fiduciary relationship, establish industry standards that bear on the debtor's knowledge of his/her fiduciary obligations, or explain the fiduciary standards of care.[36]

The debtor's credibility and the consistency of his/her testimony under oath are critically important for the subjective and objective elements of the defalcation analysis. In *In re Watterson*, the debtor provided inconsistent testimony regarding his role in various transactions, destroying his credibility with the court and resulting in a finding of defalcation.[37] In *Sveum*, false owner's affidavits that the debtor had submitted to title companies made it easy for the court to decide that the debtor's conduct justified sanctions in the form of a nondischargeable defalcation debt judgment.[38] Counsel should be cognizant of testimony provided by debtors in pre-petition litigation, declarations or affidavits, § 341 meetings, Rule 2004 examinations, depositions and at trial to highlight consistencies or inconsistencies.

Fiduciary debtors who are caught with their hands in the proverbial cookie jar had better have good explanations for their actions. If the debtor can articulate a potential interest or benefit to the trust beneficiary that outweighs the risk related to his/her misuse of entrusted funds, he/she might persuade the court that his/her actions were justified. In *Pearl*, the court found it significant that the debtor provided no testimony explaining her decisions or attempting to justify actions that otherwise appeared to be motivated by self-dealing.[39] Given the ultimate value judgment by the bankruptcy judge as to whether the debtor's conduct warranted sanctions in the form of a nondischargeable judgment, debtors should be prepared to demonstrate mitigating circumstances, and plaintiffs should submit evidence that corroborates with the debtor's gross deviation from acceptable standards of conduct.

Conclusion

Bullock resolved a disagreement among the circuit courts regarding the *scienter* requirement for defalcation, but engendered confusion regarding its application. Several years later, bankruptcy courts have developed an analytical framework comprised of subjective and objective elements that hews closely to the criminal recklessness standard espoused by the Supreme Court. Although outcomes will undoubtedly vary based on the fact-intensive nature of defalcation cases, the extent to which myriad evidentiary issues are effectively addressed at trial, and the value judgments that bankruptcy judges are required to make, the *Bullock* standard should render more consistent results under § 523(a)(4). abi

35 *Rachel*, 527 B.R. at 543.

36 *See In re Colson*, 2013 WL 5352638, at *30 (Bankr. S.D. Miss. Sept. 23, 2013) (indicating that testimony of financial experts regarding flow of funds through various accounts and fiduciary standard of care owed by debtor was crucial to court).

37 524 B.R. at 453.

38 787 F.3d at 1177.

39 *Id.* at 442-46.

No. 15–145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF *AMICUS CURIAE* G. ERIC BRUNSTAD, JR. IN SUPPORT OF RESPONDENT

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INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is an Adjunct Professor of Law at the Georgetown University Law Center where he teaches courses on bankruptcy, secured transactions, and business reorganizations and international insolvency law. He is a former Visiting Lecturer in Law at the Yale Law School, where he began teaching in 1990, a former Adjunct Professor of Law at New York University School of Law, and has also taught at the Harvard Law School. In addition to his teaching, the undersigned is a contributing author for Collier on Bankruptcy, responsible for writing several chapters of the Treatise. He is also a partner at the law firm of Dechert LLP; a prior Chair of the ABA Business Bankruptcy Committee; a former member of the Judicial Conference Advisory Committee on the Federal Bankruptcy Rules; and a Fellow of the American College of Bankruptcy.

The undersigned has briefed and argued numerous bankruptcy matters before the Court, in-

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Both petitioner and respondent have consented to the filing of this brief. Copies of petitioner's and respondent's consents are filed herewith.

cluding *Schwab v. Reilly*, 560 U.S. 770 (2010); *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010); *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008); *Travelers Cas. & Sur. Co. v. Pacific Gas & Elec. Co.*, 549 U.S. 443 (2007); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004); and *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). He has otherwise participated as counsel for one of the parties in numerous other bankruptcy matters before the Court, including *Executive Benefits Insurance Agency v. Arkison*, 134 S. Ct. 2165 (2014); *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Hamilton v. Lanning*, 560 U.S. 505 (2010); *Central Virginia Cmty. College v. Katz*, 546 U.S. 356 (2006); *Rousey v. Jacoway*, 544 U.S. 320 (2005); *Kontrick v. Ryan*, 540 U.S. 443 (2004); *Lamie v. United States Trustee*, 540 U.S. 526 (2004); *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293 (2003); and *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992). In addition, he has prepared and filed with the Court numerous amicus briefs in bankruptcy cases, including *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015); *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015); *Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015); *Clark v. Rameker*, 134 S. Ct. 2242 (2014); *Law v. Siegel*, 134 S. Ct. 1188 (2014); *Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754 (2013); *RadLAX Gateway Hotel,*

LLC v. Amalgamated Bank, 132 S. Ct. 2065 (2012); *Hall v. United States*, 132 S. Ct. 1882 (2012); *Ransom v. FIA Card Servs.*, 562 U.S. 61 (2011); *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010); *Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, 547 U.S. 651 (2006); *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004); *Archer v. Warner*, 538 U.S. 314 (2003); and *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995).

The undersigned is deeply interested in the subject of bankruptcy law and has written, taught, and lectured extensively on the subject of the bankruptcy discharge. The purpose of this brief is to address matters that bear on the Court's determination of a vitally important bankruptcy issue: whether the "actual fraud" exception to bankruptcy discharge relief in section 523(a)(2)(A) bars from discharge a debt for which the debtor is liable *not* because he intentionally and fraudulently obtained money, property, services, or credit from a creditor, but rather because he is deemed to be liable for the debts of his business under a veil piercing theory because he engaged in a "fraudulent conveyance" under state law by making transfers from his business.

The issue is important because, if accepted, Petitioner's theory of non-dischargeability would seriously impair discharge relief under the Bankruptcy Code by improperly expanding the

discharge exception of section 523(a)(2)(A) to encompass a broad range of debts without the need for a creditor to show, as section 523(a)(2)(A) requires, that the debtor owes a debt for money, property, services, or credit "obtained" through "actual fraud." That is because Petitioner's theory is *not* that Respondent owes a debt to Petitioner for goods "obtained" by fraud (which is what section 523(a)(2)(A) addresses), but rather that Respondent should not be excused from the debt because he participated in making fraudulent conveyances that resulted in Petitioner's claim going unpaid (which is beyond the scope of section 523(a)(2)(A)).

Petitioner's theory would also improperly expand section 523(a)(2)(A) because, under applicable fraudulent transfer law, fraudulent conveyance liability does not require a showing of "actual fraud." Rather, fraudulent transfer liability may be premised merely on a showing of "actual intent" to delay, hinder, or defraud, and one may be guilty of "actual intent" to delay, hinder, or defraud merely owing to the presence of four or five so-called "badges of fraud"—for example, where the debtor is insolvent, has been threatened with a debt-collection suit, makes a gift to a relative, and then incurs additional debt by making a significant charge on a credit card. In other words, the grounds for showing "actual intent" for fraudulent transfer purposes is quite different from, and less exacting than, what is

traditionally necessary to show "actual fraud" as the term is used in section 523(a)(2)(A).

This brief explains why the Fifth Circuit was correct in finding that the debt at issue falls outside the scope of section 523(a)(2)(A). The text of the provision, its context, relevant principles of statutory construction, and its history all counsel that the "actual fraud" exception of section 523(a)(2)(A) requires that the debtor have engaged in some kind of affirmative fraudulent conduct in *obtaining* money, property, services, or credit from the creditor, and simply does not encompass Petitioner's claim in this matter. This brief offers a unique contribution by focusing on how Petitioner's overreaching theory seriously threatens the integrity of discharge relief.

STATEMENT

Petitioner Husky International Electronics, Inc. ("Husky") is a seller of electronic device components. Pet. App. 2a. From 2003 to 2007, Husky sold and delivered goods to Chrysalis Manufacturing Corp. ("Chrysalis"), a company that manufactured electronic circuit boards, pursuant to a written contract. Pet. App. 2a, 38a. Chrysalis failed to pay for the goods it purchased from Husky, resulting in an unpaid debt of $163,999.38. Pet. App. 2a.

At all relevant times, Respondent Daniel Lee Ritz, Jr. ("Ritz") was a director and partial owner

of Chrysalis and was in financial control of the company. Pet. App. 2a. Between November 2006 and May 2007, Ritz caused Chrysalis to make several transfers of assets to other entities also under his control. Pet. App. 81a-82a. Husky sued Ritz in federal district court in May 2009, claiming that Ritz was personally liable for Chrysalis's debt under Texas law. Pet. App. 39a. On December 31, 2009, Ritz filed a voluntary chapter 7 bankruptcy petition. Pet. App. 79a. Thereafter, Husky initiated an adversary proceeding in Ritz's bankruptcy case, claiming that (1) due to his actions Ritz is personally liable for Chrysalis's debt, and (2) the alleged debt is non-dischargeable in Ritz's chapter 7 bankruptcy case. Pet. App. 78a-79a. As is relevant here, Husky claims that the debt is non-dischargeable under section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. § 523(a)(2)(A), which excepts from discharge "any debt" for "money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." Pet. App. 79a.

Notably, Husky's contention is *not* that Ritz himself contracted with Husky to obtain the goods in question. Nor is it Husky's claim that Ritz fraudulently induced Husky to supply the goods by making some kind of misrepresentation. Rather, Husky's claim is that Ritz is liable for Chrysalis's debt for the goods on a combined state-law veil-piercing and fraudulent convey-

ance theory. Husky's veil piercing argument is that, under applicable Texas law, the owner of a corporation may be responsible for the corporation's debts if the owner "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the [creditor] primarily for the direct personal benefit of the . . . owner . . . ." Tex. Bus. Orgs. Code § 21.223. Husky asserts that Ritz perpetrated an "actual fraud" as section 21.223 requires by invoking section 24.005(a)(1) of the Texas Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code § 24.005(a)(1). Section 24.005(a)(1) permits the avoidance of transfers made "with actual intent to hinder, delay, or defraud any creditor of the debtor." Husky's theory is that Ritz committed "actual fraud" for purposes of section 21.223 because Ritz made the transfers with "actual intent" to hinder, delay, or defraud Chrysalis's creditors under section 24.005(a)(1).

Notably, however, there is a critical difference between "actual fraud" and "actual intent" to hinder, delay, or defraud. A determination of "actual intent" to hinder, delay, or defraud under section 24.005(a)(1) does not require the kind of intentional wrongdoing traditionally associated with actual fraud. Rather, courts in Texas have held that "actual intent" to hinder, delay, or defraud for fraudulent transfer purposes may be demonstrated on the basis of the presence of four or five so-called "badges of fraud," which are listed non-exhaustively in section 24.005(b). *See*

Pet. App. 44a-45a n.13, 71a-72a. These "badges of fraud" include such things as (1) the debtor was insolvent when the transfer was made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, fraudulent transfer liability under section 24.005(a)(1) may attach where a debtor is insolvent, has been threatened with a debt-collection suit (as many insolvent debtors are), makes a gift to a relative (such as by giving funds to a family member to buy medicine or pay the rent), and the debtor then incurs additional debt by making a significant charge on a credit card. This is far afield from the kind of conduct traditionally associated with "actual fraud."

The bankruptcy court rejected Husky's theory, concluding first that Ritz was not liable for Chrysalis's debt under Texas veil-piercing law (section 21.223 of the Texas Business Organizations Code) and, second, that the debt was not excepted from discharge under section 523(a)(2)(A), because Ritz had not committed "actual fraud" within the meaning of either statute. Pet. App. 91a-93a. "Actual fraud," the court noted, "is defined as 'the misrepresentation of a material fact with intention to induce action or

inaction, reliance on the misrepresentation by a person who, as a result of such reliance, suffers injury.'" Pet. App. 91a (citation omitted). Finding the record to be "wholly devoid of any such representation" on the part of Ritz, the court held that fraud had not been demonstrated either for purposes of Texas veil-piercing law or section 523(a)(2)(A) of the Bankruptcy Code. Pet. App. 92a.

On appeal, the district court disagreed with the bankruptcy court's veil-piercing determination, but agreed that the debt was not excepted from discharge under section 523(a)(2)(A). Pet. App. 72a. On the veil-piercing issue, the district court concluded that, because four or five "badges of fraud" were present in the case, Ritz's transfers from Chrysalis qualified as fraudulent conveyances under the "actual intent" provision of section 24.005(a)(1). Pet. App. 71a-72a. In turn, the court concluded that, because these transfers satisfied the "actual intent" requirement of section 24.005(a)(1), they also constituted "actual fraud" for purposes of section 21.223. Thus, the corporate veil could be disregarded.

On the dischargeability issue, however, the district court found the facts to be insufficient to satisfy section 523(a)(2)(A). In reaching its conclusion, the court cited *Field v. Mans*, 516 U.S. 59, 69 (1995) for the proposition that the term "actual fraud" in section 523(a)(2)(A) should be

construed according to its established common-law meaning. Pet. App. 72a. The court concluded that "[b]ecause the common law interpretation of § 523(a)(2)(A) requires a misrepresentation and there is no evidence here that Ritz made one, Husky's claim of nondischargeability under the statute fails." Pet. App. 73a.

On further appeal, the Fifth Circuit affirmed, also determining that the "actual fraud" exception to discharge under section 523(a)(2)(A) requires that the debtor have made some kind of false representation to the creditor. Pet. App. 6a-7a. "Guided by Supreme Court and Fifth Circuit precedent," Pet. App. 7a, the court below stated that this Court's decision in *Field* "appeared to assume that a false representation is necessary to establish 'actual fraud,'" Pet. App. 10a. The Fifth Circuit declined to follow the Seventh Circuit's decision in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), which held that "actual fraud" under section 523(a)(2)(A) included not only false representations, but also extended to "conveyances through which the debtor intends to hinder the creditor." Pet. App. 7a-8a. The Fifth Circuit reasoned that the *McClellan* decision was "in tension with" *Field* and noted that "[n]o subsequent appellate court has adopted the interpretation of Section 523(a)(2)(A) endorsed by the *McClellan* majority." Pet. App. 9a.

SUMMARY OF THE ARGUMENT

The bankruptcy discharge is a fundamental element of bankruptcy law that vindicates the primary bankruptcy policy of the "fresh start"—the idea that an insolvent debtor may be released from preexisting civil liabilities so that he or she may start over, free from the burden of oppressive indebtedness. Without the bankruptcy discharge, millions of insolvent individuals would remain locked in a state of perpetual indebtedness well beyond their ability to repay. Recognizing the centrality of discharge relief in the administration of bankruptcy cases, this Court has repeatedly stressed its importance in the interpretation of the Bankruptcy Code. *See, e.g., Schwab v. Reilly*, 560 U.S. 770, 803 (2010) (noting that the bankruptcy provisions "must be construed" in light of the policy "to give the bankrupt a fresh start" (citing *Burlingham v. Crouse*, 228 U.S. 459, 473 (1915))).

Although the Code provides generous discharge relief to insolvent individuals, this relief is not without limits. Among the limitations are those set forth in section 523(a)(2)(A), which excepts from discharge "any debt" for "money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). By its plain terms, this provision most naturally applies to a situation in which a debtor has "ob-

tained" from a creditor money, property, services, or credit through the use of some kind of intentional, affirmative fraud, such as by means of an outright deceit of some kind in enticing the creditor to provide goods or a loan. In this case, however, Ritz engaged in no such affirmative misconduct in acquiring any money, property, services, or credit from Husky. In fact, Ritz did not acquire anything from Husky—Chrysalis did. Nor did Ritz induce Husky to deliver any money, property, services, or credit on the basis of any kind of deceptive statement—as the bankruptcy court determined, the record is devoid of any evidence of any such thing. Rather, what Ritz stands accused of doing is making various transfers of funds from Chrysalis to other businesses that he controlled. This, however, is not the kind of conduct to which section 523(a)(2)(A) applies.

Husky's theory is that Ritz's conveyances constitute fraudulent transfers made with "actual intent" to hinder, delay, or defraud creditors within the meaning of section 24.005(a)(1) of the Texas Uniform Fraudulent Transfer Act. Tex, Bus. & Com. Code § 24.005(a)(1). Husky contends that this designation of "actual intent" is sufficient to establish that Ritz engaged in "actual fraud," not only for purposes of making Ritz liable for Chrysalis's debt to Husky under Texas veil-piercing law, but also to render the debt excepted from discharge under section 523(a)(2)(A). Husky's theory, however, does not square with

the text, context, purpose, or history of section 523(a)(2)(A). Moreover, if Husky's theory were accepted, it would improperly expand the scope of section 523(a)(2)(A) and seriously erode bankruptcy discharge relief.

Concededly, Ritz's transfers of funds from Chrysalis to other businesses he controlled may well have left Chrysalis with insufficient means to pay its bills, but that is not what section 523(a)(2)(A) addresses. Section 523(a)(2)(A) does *not* provide that a debtor who engages in a fraudulent transfer is barred from being discharged from his unpaid debts. On the contrary, a very different provision of the Bankruptcy Code, section 727(a)(2)(A), 11 U.S.C. § 727(a)(2)(A), governs that situation in a very precise and limited way—and one that does not assist Husky in this instance. Because section 523(a)(2)(A) does not address such circumstances, Husky's theory is an improper attempt to rewrite section 523(a)(2)(A) to govern matters beyond its scope.

More important, accepting Husky's interpretation would seriously undermine discharge relief generally. Under Texas fraudulent transfer law, a debtor may be determined to be guilty of "actual intent" to hinder, delay, or defraud if four or five so-called "badges of fraud" are present. *See* Pet. App. 44a-45a n.13, 71a-72a. These badges of fraud include such things as (1) the debtor was insolvent when the transfer was

made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, an insolvent mother who has been threatened with a debt-collection action by a credit card company who gives her adult child a gift of money so the child can pay his rent just after making some significant charges on her credit card may be guilty of "actual intent" to hinder, delay, or defraud in making the gift to the child. Under Husky's theory, this, in turn, would qualify as "actual fraud" rendering the mother's unpaid debts non-dischargeable under section 523(a)(2)(A) simply because, by making the gift, she participated in a "fraudulent" scheme. That cannot be a correct interpretation of section 523(a)(2)(A), yet it is the logical consequence of Husky's theory. For these reasons, as well as those argued by Respondent, the decision of the Fifth Circuit rejecting Husky's erroneous interpretation should be affirmed.

ARGUMENT

The Fifth Circuit Concluded Correctly That Husky's Claim Does Not Fall Within The Scope Of Section 523(a)(2)(A).

Because section 523(a)(2)(A) applies only to certain kinds of "debts," it is critical at the outset to pinpoint precisely the debt at issue. Here, the relevant debt that Husky is attempting to collect from Ritz is Husky's claim for $163,999.38 for goods Husky sold to Chrysalis. Husky's theory of liability is *not* that Ritz fraudulently induced Husky to part with the goods Husky sold. Rather, Husky's theory is that, because Ritz participated in making fraudulent transfers from Chrysalis, the corporate veil between Ritz and Chrysalis should be pierced and Ritz held responsible for Chrysalis's liability. More precisely, Husky contends that the veil should be pierced on grounds of "actual fraud" under section 21.223 of the Texas Business Organizations Code because Ritz made the transfers with "actual intent" to hinder, delay, or defraud within the meaning of section 24.005(a)(1) of the Texas Fraudulent Transfer Act. Husky then contends that, because Ritz committed "actual fraud" for purposes of Texas's veil-piercing provision by reason of his "actual intent" to hinder, delay, or defraud under Texas fraudulent transfer law, Ritz's debt should be non-dischargeable under the "actual fraud" provision of section 523(a)(2)(A).

The initial problem with Husky's theory is that the particular *debt* that Husky is trying to enforce against Ritz—Husky's claim for $163,999.38 for goods sold to Chrysalis—is plainly not a debt for money, property, services, or credit *obtained by* fraud, and thus does not fall at all within the scope of section 523(a)(2)(A). Notably, Husky's overall theory of liability—that Ritz engaged in fraudulent transfers—*does* fall within the general purview of another discharge provision of the Bankruptcy Code, section 727(a)(2)(A). But a comparison of the terms of sections 727(a)(2)(A) and 523(a)(2)(A) reveals that their respective requirements are different. Moreover, these differences are important because they underscore why the decision below was correct.

Whereas section 523(a)(2)(A) applies only to specific debts, section 727(a)(2)(A) operates to deny *all* discharge relief of *all* of the debtor's debts in a chapter 7 proceeding if "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor, within one year before the date of the filing of [the debtor's bankruptcy case]." 11 U.S.C. § 727(a)(2)(A). By its terms, this provision addresses directly the dischargeability of a debtor's obligations where the debtor has engaged in fraudulent conveyances. This provision does not assist Husky, however, for two reasons. First, the provision applies only to the debtor's transfer of his own property. Second, it is limited to

transfers made within one year before the filing of the debtor's bankruptcy case. Here, the transfers in question did not involve Ritz's property and were made more than a year before he filed his chapter 7 petition.

In contrast, section 523(a)(2)(A) operates more surgically to deny a discharge only with respect to a particular "*debt* for money, property, services, or [credit] to the extent *obtained*, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A) (emphasis added). As is relevant here, this section requires three basic things: (1) a debt (2) for money, property, services, or credit (3) obtained by actual fraud. But here the debt—the unpaid $163,999.38—was not for goods obtained by actual fraud. It was for goods Husky sold to Chrysalis under their contract. The alleged "fraud" in the matter occurred separately in the form of Ritz's participation in transfers from Chrysalis to other businesses. But section 523(a)(2)(A) does not deny the dischargeability of a debtor's debts simply because the debtor participated in a fraudulent transfer—that is the office of section 727(a)(2)(A) in a manner inapplicable to this case. Section 523(a)(2)(A) only denies a discharge for specific debts for money, property, services, or credit obtained by actual fraud. Husky attempts to elide the disparate elements of the two provisions with its argument that the relevant debt at issue here is nondischargeable under section 523(a)(2)(A) because

Ritz participated in a kind of fraudulent activity to Husky's detriment. *See, e.g.*, Pet. Br. at 14-15. But that is not what section 523(a)(2)(A) covers.

Seizing on this deficiency in Husky's approach, the Fifth Circuit correctly concluded that the debt Husky is attempting to collect from Ritz does not fall within the scope of section 523(a)(2)(A) because the debt is not one for money, property, services, or credit that Ritz obtained by actual fraud. More precisely, the court reasoned that, because the concept of "actual fraud" has traditionally required some kind of misrepresentation, Husky's failure to show that Ritz procured the goods through some kind of deceptive statement is fatal to Husky's claim. The Fifth Circuit was further correct in its holding because the fact that a debtor may be guilty of "actual intent" to hinder, delay, or defraud creditors for fraudulent transfer purposes is not a sufficient substitute for "actual fraud" under section 523(a)(2)(A). The concept of "actual intent" to hinder, delay, or defraud is different from, and less exacting than, the concept of "actual fraud." Interpreting section 523(a)(2)(A) to deny the dischargeability of a debt on the basis of the "actual intent" standard under fraudulent transfer law would vastly expand the scope of section 523(a)(2)(A), dislodging section 727(a)(2)(A), and imperiling discharge relief in innumerable settings far beyond anything Congress has provided for in the language it actually used in creating

its carefully tailored statutory scheme. The decision below should be affirmed.

A. Section 523(a)(2)(A) Should Be Construed Narrowly In Accordance With Its Plainly Expressed Terms.

Discharge relief has long been a critical aspect of bankruptcy law. *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (noting one of the primary purposes of bankruptcy law is to excuse an insolvent debtor "'from the weight of oppressive indebtedness, and permit him to start afresh'" (quoting *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 554-55 (1915))). Its importance is underscored by its breadth, applying generally as it does to "'*all debts that arose before the bankruptcy*.'" *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293, 303 (2003) (quoting *Ohio v. Kovacs*, 469 U.S. 274, 278 (1985)) (emphasis in original); *see also* 11 U.S.C. § 1141(d) (providing discharge of "any debt" arising before confirmation of a plan, except for those debts excepted from discharge in section 523 of the Bankruptcy Code). Discharge relief is so important that the Bankruptcy Code prevents individuals from waiving it *ex ante* at the time they incur debt, *see* 11 U.S.C. § 524(a), and likewise places substantial *ex post* restrictions on the ability of debtors to waive the discharge with respect to particular debts, *see id.* § 524(c). Such protections reflect Congress's judgment that the discharge should remain broadly available, and

any impediments to invoking the discharge are rightfully limited to those Congress has expressly prescribed.

Reflecting this value, this Court has long followed the rule that the exceptions to discharge are to be "confined to those plainly expressed," *Gleason v. Thaw*, 236 U.S. 558, 562 (1915), and has rejected efforts to expand their reach through creative interpretations inconsistent with the wording of the statutory language used. *See Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754, 1760-61 (2013) (rejecting an interpretation of 11 U.S.C. § 523(a)(4) that would have broadened the defalcation exception); *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (rejecting petitioner's broad interpretation of 11 U.S.C. § 523(a)(6) as "incompatible with the 'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed'" (quoting *Gleason*, 236 U.S. at 562)). Indeed, the canon requiring tight construction of the discharge exceptions is by now a well-established tenet of bankruptcy jurisprudence, and was properly followed by the court below. *See* Pet. App. at 16a-17a; 4 COLLIER ON BANKRUPTCY ¶ 523.05 (16th ed. 2015) ("In determining whether a particular debt falls within one of the exceptions of section 523, the statute should be strictly construed against the objecting creditor and liberally in favor of the debtor. Any other construction would be inconsistent with the liberal spirit

that has always pervaded the entire bankruptcy system.").

In urging this Court to adopt its expansive reading of section 523(a)(2)(A), Husky's proposed interpretation—that participation in a fraudulent conveyance scheme under the "actual intent" standard of fraudulent transfer law is sufficient to constitute "actual fraud"—effectively urges the Court to abandon its longstanding practice, and with it the values that undergird Congress's ambitions for its fresh start policy. As it has in the past in cases involving even truly egregious facts, the Court should reject that offer.

In *Kawaauhau*, for example, the Court was presented with a creditor who had won a money judgment against a doctor for negligence resulting in the amputation of the creditor's right leg below the knee. 523 U.S. at 59. The doctor carried no malpractice insurance and declared bankruptcy soon after the judgment. *Id.* at 60. The patient sought to have the judgment excepted from discharge as a "willful and malicious injury" under section 523(a)(6) of the Bankruptcy Code, but this Court properly found that that exception, by its terms, only encompassed intentional torts where the debtor intended the injury, not simply negligence cases involving serious harm. *Id.* at 61-62. The judgment debt was therefore dischargeable.

Just as this Court rejected a strained reading of the statute in *Kawaauhau*, it should reject Husky's strained reading here. To hold otherwise would mark an unprecedented departure from this Court's well-established practice of construing tightly the exceptions to discharge relief.

B. The Text and Structure Of Section 523(a)(2)(A) Show That Congress Intended "Actual Fraud" To Require A Misrepresentation.

"The starting point in discerning congressional intent is the existing statutory text[.]" *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (citing *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999)); *see also United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) ("The task of resolving the dispute over the meaning of [the statutory provision at issue] begins where all such inquiries must begin: with the language of the statute itself."). Here, the text and structure of section 523(a)(2)(A), together with its history, demonstrate that Congress intended to limit "actual fraud" to debts resulting from the debtor's misrepresentation to the creditor.

As noted, section 523(a)(2)(A) excepts from discharge "any debt for money, property, services, or [credit] . . . obtained, [sic] by false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). Congress added the

"actual fraud" term to section 523(a)(2)(A) in 1978, but the fraud exception itself dates back to earlier bankruptcy enactments. *See Field v. Mans*, 516 U.S. 59, 64-65 (1995) (discussing history of section 523(a)(2)(A)); *see also Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998). As the Fifth Circuit noted below, Congress's addition of "actual fraud" in 1978 did not substantially change the scope of the fraud exception; the pre-1978 and post-1978 versions of the exception were "substantially similar." Pet. App. 15a (citing *Cohen*, 523 U.S. at 221). Its addition made clear that the fraud targeted by the exception was actual and positive fraud.

This Court previously construed the "actual fraud" term in *Field*, where it found that the term, along with "false pretenses" and "false representation" "carry the acquired meaning of terms of art" that "imply elements that the common law has defined them to include." *Field*, 516 U.S. at 69 (noting "'where Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms'") (citation omitted). In deciding the degree of reliance necessary to show "actual fraud," the Court looked to both the Restatement (Second) of Torts and Prosser's Law of Torts in effect at the time of the term's addition to the statute. *Id.* at 70. Following the lead of *Field*, the Fifth Circuit in this case looked to the

same sources to construe "actual fraud," finding that both indicated that, at common law, a false representation was a necessary prerequisite for "actual fraud." Pet. App. 11a-12a (discussing *Field*, 516 U.S. at 70; Restatement (Second) of Torts § 537 (1977); William J. Prosser, Law of Torts, § 106, p. 694 (4th ed. 1971)). As the Fifth Circuit further noted, not only did the *Field* Court assume that a false representation is necessary to establish "actual fraud," Justice Breyer's dissenting opinion affirmatively noted his support for the proposition. Pet. App. 10a; *see also Field*, 516 U.S. at 79 (Breyer, J., dissenting) ("I agree with the Court's holding that 'actual fraud' under 11 U.S.C. § 523(a)(2)(A) incorporates the common-law elements of intentional misrepresentation.").

Other authority supports the Fifth Circuit's reading of "actual fraud" as requiring a false representation at common law. When the Court considered, in *Bullock*, the meaning of "defalcation" in section 523(a)(4), it noted that "'[f]raud' typically requires a false statement or omission." *Bullock*, 133 S. Ct. at 1760 (citing W. LaFave, Criminal Law § 19.7 (5th ed. 2010)). Black's Law Dictionary is also in accord. *See* BLACK'S LAW DICTIONARY 775 (10th ed. 2014) (defining "actual fraud" as "[a] concealment or false representation through an intentional or reckless statement or conduct that injures another who relies on it in acting"). Finally, Collier's explains that to "sustain a prima facie case of [actual]

fraud, a plaintiff under section 523(a)(2) must establish that: (1) *the debtor made the representation*; (2) *at the time of the representation*, the debtor knew it to be false; (3) *the debtor made the representation* with the intent and purpose of deceiving the plaintiff; (4) the plaintiff justifiably relied *on the representation*; and (5) the plaintiff sustained a loss or damage as the proximate consequence of *the representation having been made*." 4 COLLIER ON BANKRUPTCY ¶ 523.08-[1][e] (16th ed. 2015) (emphasis added).

The Fifth Circuit's construction of "actual fraud" makes even more sense when looking at the rest of section 523(a)(2)(A). The provision requires that debt be "obtained, [sic] by . . . actual fraud." 11 U.S.C. § 523(a)(2)(A). Section 523(a)(2)(A) therefore explicitly requires causation—Congress limited the exception to those debts *caused* by a debtor's fraud. *See Field*, 516 U.S. at 66 (noting there is no dispute that "some degree of reliance is required to satisfy the element of causation in the phrase 'obtained by'"). For a debt to be caused by the debtor's fraud, the creditor needs to have relied on some action or omission by the debtor—a false representation. But under Husky's construction of "actual fraud," the creditor's reliance need be tied to nothing of the sort because, under Husky's theory, the creditor need only show that the debtor engaged in some kind of fraudulent activity not necessarily related to the incurrence of the debt—a formulation that makes little sense. *See*

Pet. Br. at 24 (arguing that actual fraud means intentional fraud without regard for whether the fraudulent conduct involved a misrepresentation).

Likewise, the causation requirement of section 523(a)(2)(A) demonstrates why Husky's attempt to limit *Field* to its facts does not succeed. *Field* determined that the crux of section 523(a)(2)(A) is reliance. *See Field*, 516 U.S. at 66. In doing so, its holding rested on the understanding that "actual fraud" requires a misrepresentation; otherwise, without a misrepresentation, there would be no basis to determine causation.

Applicable canons of statutory construction confirm the Fifth Circuit's reading of "actual fraud." Section 523(a)(2)(A) groups "actual fraud" alongside "false pretenses" and "false representation." Under the commonplace principle *noscitur a sociis*, whereby a word is known by the company it keeps, the meaning of "actual fraud" is informed by its neighbors—both of which require some representation by the debtor to the creditor. *See Yates v. United States*, 135 S. Ct. 1074, 1085 (2015) (noting *noscitur a sociis* prevents the Court from "'ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving unintended breadth to the Acts of Congress'") (citation omitted); *see also United States v. Williams,* 553 U.S. 285, 294 (2008) ("a word is given more precise

content by the neighboring words with which it is associated"). Similarly, the principle *ejusdem generis* counsels that, "'where general words follow specific words in a statutory enumeration, the general words are [usually] construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" *Yates*, 135 S. Ct. at 1086 (quoting *Washington State Dep't of Social and Health Servs. v. Guardianship Estate of Keffeler,* 537 U.S. 371, 384 (2003)) (internal quotation marks omitted). Applying that principle here, the meaning of "actual fraud" is properly informed and cabined by the terms preceding it. As both false pretenses and false representation properly rest on a representation from debtor to creditor, so too should "actual fraud."

Section 523(a)(2)(A)'s larger statutory context further reinforces the notion that Congress never intended for "actual fraud" to serve as a catch-all provision, either for fraudulent activity generally or fraudulent transfer activity specifically. Section 523 contains other provisions directed specifically at particular kinds of fraudulent activity: for example, excepting from discharge debts based on materially false statements in writing respecting the debtor's or insider's financial condition, as well as debts resulting from fraud or defalcation while the debtor was acting in a fiduciary capacity, embezzlement, or larceny. 11 U.S.C. §§ 523(a)(2)(B), 523(a)(4). Moreover, as noted, an entirely separate provision of the

Bankruptcy Code denies discharge relief where a debtor has committed certain kinds of fraudulent transfers. *See* 11 U.S.C. § 727(a)(2)(A). Construing section 523(a)(2)(A) to include what section 727(a)(2)(A) already covers would effectively render the latter provision superfluous—a result to be avoided. *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001))). In sum, consistent with the Court's reasoning in *Field*, these principles of statutory interpretation likewise reinforce the conclusion that Husky's proposed interpretation of section 523(a)(2)(A) is unsound and the decision below is correct.

C. If Accepted, Husky's Interpretation of Section 523(a)(2)(A) Would Seriously Undermine Discharge Relief.

Husky contends that its interpretation of section 523(a)(2)(A) is defensible on the ground that, in this instance, the fresh start policy is outweighed by "the interest of defrauded creditors in 'being made whole.'" Pet. Br. at 53 (quoting *Cohen*, 523 U.S. at 222). But apart from the fact that this is a judgment best reserved for Congress that Congress has not, in fact, expressed in the governing statutory text, Husky's interpretation would potentially deny discharge

relief to a vast assortment of debtors who did not actually intend to defraud anyone. That is so because of the nature of fraudulent transfer liability.

As noted, a debtor may be guilty of "actual intent" to hinder, delay, or defraud under the Texas law of fraudulent transfers (which is similar to the fraudulent transfer laws of most states) if the creditor proves the existence of four or five so-called "badges of fraud," which are listed non-exhaustively in section 24.005(b) of the Texas Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code § 24.005(b). *See* Pet. App. 44a-45a n.13, 71a-72a. These "badges of fraud" include such things as (1) the debtor was insolvent when the transfer was made, (2) the debtor made the transfer without receiving in exchange reasonably equivalent value (e.g., the debtor made a gift), (3) the debtor made the transfer to an insider (e.g., to a relative), (4) the debtor had been sued or threatened with a suit before the transfer, and (5) the debtor incurred a significant debt shortly before or after making the transfer. Tex. Bus. & Com. Code § 24.005(b). Thus, as noted previously, fraudulent transfer liability may attach where an insolvent debtor who has been threatened with a debt-collection action makes a gift to a family member and then incurs some additional debt by making a significant charge on a credit card. These considerations can be mixed and matched in all kinds of ways to encompass many situations in which the debtor did

not actually intend to defraud anyone, but nonetheless ran afoul of the strictures of the fraudulent conveyance laws. This is plainly not what Congress had in mind when it enacted section 523(a)(2)(A). Yet it is the logical extension of Husky's theory.

Take, for example, an insolvent debtor who makes a substantial payment to a hospital in order to pay for a treatment for an ill parent. If a creditor previously threatened the debtor with a debt-collection suit (such as in a letter threatening to take collection action if a debt is not paid), and the debtor makes a significant charge on the debtor's credit card shortly before or after making the payment, the debtor could be guilty of "actual intent" to hinder, delay, or defraud creditors, in which event none of the debtor's debts would be discharged under Husky's reading of section 523(a)(2)(A). This goes too far.

Ignoring the harmful effects that Husky's construction of section 523(a)(2)(A) would inflict on the current system of bankruptcy relief, certain of Husky's *amici* argue that the decision below should be overturned because it could be used to benefit debtors who intentionally defraud their creditors while purposefully avoiding any misrepresentation, thereby intentionally evading section 523(a)(2)(A). *See* Br. of Bankruptcy Law Profs. as *Amici Curiae* in Support of Petitioner at 28. These *amici* offer as an illustration a Ponzi scheme executed through multiple layers

of feeder funds whereby the ultimate perpetrator of the fraud never makes any actual representation to the hundreds or thousands of investors harmed by the fraud. *Id.* at 28-29. This hypothetical, however, is both unusual and overwrought. First, such schemes typically constitute federal crimes that entail criminal restitution obligations that are not dischargeable under section 523(a)(13). 11 U.S.C. § 523(a)(13). Second, even if any resulting civil liability might not be excepted from discharge under section 523(a)(2)(A), this does not mean that some other exception would not apply. There are several potential candidates, including the exception for debts for fraud while acting in a fiduciary capacity, *id.* § 523(a)(4), if the debtor "has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information . . . from which the debtor's financial condition or business transactions might be ascertained," *id.* § 727(a)(3), or if the debtor is unable "to explain satisfactorily . . . any loss of assets or deficiency of assets to meet the debtor's liabilities, *id.* § 727(a)(5).

In reality, the far more pressing concern is not that perpetrators of Ponzi schemes will find shelter in the arms of the bankruptcy court, but rather that Husky's reading stretches section 523(a)(2)(A) too far and would deny discharge relief to debtors Congress intended to assist with a fresh start. Indeed, under Husky's theory, the denial of a discharge could become the rule for

many ordinary debtors rather than the exception. Husky's theory is thus unsound.

CONCLUSION

For the foregoing reasons, as well as those briefed by Respondent, the decision of the court below should be affirmed.

Respectfully submitted,

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January 27, 2016

Positive
As of: March 14, 2016 7:35 PM EDT

In re DeCelis

United States Bankruptcy Court for the Eastern District of Virginia, Alexandria Division

September 22, 2006, Decided

Case No. 05-11844-RGM (Chapter 7)

Reporter
349 B.R. 465; 2006 Bankr. LEXIS 2475; 2006 WL 2720974

In re: WALTER RUBIN DeCELIS, Debtor.

Core Terms

free and clear, liens, lienholder, consented, silence, notice, fail to object, collateral attack, sale order, proceeds, township, parties, bankruptcy court, implied consent, transfers, cases, void, authority to sell, bona fide dispute, proposed action, liquor license, proposed sale, trustee's, adversary proceeding, sale of property, court found, co-owners, scheduled, conveyed, issues

Case Summary

Procedural Posture
In an adversary proceeding, a trustee obtained a default order declaring that the transfer by defendant debtor to defendant co-owner of an interest in a house was void. After learning that the debtor and the co-owner acquired title to the subject property as tenants in common from the same grantors in a single deed, the trustee filed a motion to sell the property free and clear of the co-owner's interest pursuant to *11 U.S.C.S. § 363(f)*.

Overview
The co-owner did not appear in the adversary proceeding, and he did not respond to the trustee's motion to sell the property. The trustee argued that the co-owner's silence constituted consent to the sale under *11 U.S.C.S. § 363(f)(2)*. The court held that the co-owner's silence did not constitute implied consent because consent required an act affirmatively approving the proposed action and the Bankruptcy Code imposed no duty to respond to notices. The court found that the trustee placed uncritical reliance on cases in which the statement that silence was consent was dictum; furthermore, the cases on which the trustee relied involved collateral attacks on orders authorizing a sale free and clear of liens and interests. The court concluded that it would deny the trustee's motion to sell free and clear because the co-owner had not consented to the sale and there was no bona fide dispute as to the co-owner's ownership interest in the property.

Outcome
The court denied the trustee's motion to sell the property free and clear of the co-owner's interest.

LexisNexis® Headnotes

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN1 See *11 U.S.C.S. § 363(f)*.

Bankruptcy Law > Procedural Matters > General Overview

HN2 *11 U.S.C.S. § 102(1)(B)(I)* requires a party who opposes a proposed action to request a hearing. However, no such duty can be implied from the common meaning of the word "consent." If a party's consent is a prerequisite to proceeding with a proposed action, then that party should not have to request a hearing or otherwise object if it does not want the action to occur. Its silence should be sufficient.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Bankruptcy Law > Procedural Matters > General Overview

HN3 The distinction between silence and consent is clear. Unless there is a duty to speak, silence signifies nothing. The Bankruptcy Code imposes no duty to respond to notices. The "notice and hearing" process permits the court to take certain actions if there is no objection. The procedure is necessary if any meaningful and timely

administration of bankruptcy estates, either in liquidation or reorganization, is to be achieved. It assures that all necessary parties know what the proposed action is and that they are given an opportunity to participate. *11 U.S.C.S. § 102(1)*. That, though, is different from consent, an act affirmatively approving the proposed action. Had Congress intended silence to be consent in *11 U.S.C.S. § 363(f)(2)*, it knew how to say so. It did not.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN4 The trustee may sell property of the estate free of liens or other interests when the holder of the lien or interest consents to such a sale. This provision is similar to *U.C.C. § 9-315(a)*, which permits a sale free of a security interest when the secured party consents to such a sale. The consent required is consent to a sale free of liens or interests, not merely consent to sale of the assets. The consent may be express or may be implied from circumstances surrounding the sale.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN5 *11 U.S.C.S. § 363(f)(2)* requires consent and that consent may be either express or implied.

Civil Procedure > Judgments > Relief From Judgments > Void Judgments

HN6 In a collateral attack of an order, the issue ought to be whether the order was void, not whether it was correct.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN7 Under *11 U.S.C.S. § 363(f)(2)* consent is required only of those with actual interests in a debtor's property. Whether all actual interests have been identified and dealt with in accordance with one of the five alternatives under *§ 363(f)* is a factual question that must be resolved before a sale free and clear may be authorized. If there is doubt as to whether a party has an interest in the property to be sold, the parties frequently consent to the sale with interest, if any, attaching to the proceeds, thus preserving the status quo. If, however, the parties do not agree to the sale and the dispute as to the interest is a bona fide dispute, consent of the alleged interest holder is unnecessary. *11 U.S.C.S. § 363(f)(4)*. If the interest is a disputed lien, *§ 363(f)(3)* is also available.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Civil Procedure > Judgments > Relief From Judgments > General Overview

HN8 When a party brings a collateral attack on a prior order of the court authorizing a sale free and clear of liens and interests, it is not enough to show that the court was factually wrong. Instead, the party must show that it is entitled to relief from the erroneous order under *Fed. R. Bankr. P. 9023* or *9024*, which incorporate *Fed. R. Civ. P. 59* and *60*.

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Judges: Robert G. Mayer, United States Bankruptcy Judge.

Opinion by: Robert G. Mayer

Opinion

[*466] **MEMORANDUM OPINION**

This case is before the court on the trustee's motion to sell real property owned by the debtor and Carlos Chevez free and clear of liens under *§ 363(f) of the Bankruptcy Code*. For the reasons stated below, the motion will be denied.

Background

Walter R. DeCelis filed a petition in bankruptcy under chapter 7 of the Bankruptcy Code on July 18, 2005. He scheduled a house which he did not claim as exempt. He also scheduled Carlos Chevez as the co-obligor of the note secured by the house. The trustee filed a complaint against the debtor, Chevez and two others. He alleged in the complaint, which was filed without the benefit of a title examination, that "On or about August 3, 2004 Debtor acquired a fee simple interest in [the house] . . . On or [**2] after August 3, 2004, Defendant Chevez acquired

an interest in the [the house]." He further alleged that on or about March 7, 2005, the debtor and Chevez conveyed the property to the other two defendants. [1] The deeds, the trustee alleged, were not recorded. The trustee sought to avoid the transfers as fraudulent transfers under the Bankruptcy Code and the Virginia Code. The two additional defendants then conveyed the property to the debtor and Chevez, effectively putting the property back in the same ownership as before they became involved in the transactions. Chevez did not appear in the adversary proceeding and a default order drafted by the trustee's counsel was entered declaring "the transfer by Defendant DeCelis to Defendant Chevez of an interest in the [house] is void."

[**3] The trustee, still without a title examination, marketed the property and entered into a sales contract which he estimated would net the estate $ 81,400 after payment of liens of record, sales commissions and closing costs. His motion to sell was granted and he proceeded to settlement. The sale was authorized under *Bankruptcy Code § 363(b)* but not *§ 363(f)*.

The settlement agent obtained a title examination. He discovered that the debtor and Chevez acquired title as tenants in common from the same grantors in a single deed. There never had been a transfer from the debtor to Chevez. He questioned [*467] whether the default order voiding the nonexistent transfer from the debtor to Chevez accomplished anything. With the conveyance from the two additional defendants to the debtor and Chevez, he questioned whether the trustee who had the undoubted authority to sell the debtor's interest, had authority to sell Chevez' interest.

To remedy the situation, the trustee filed the present motion to sell the house free and clear of Chevez' ownership interest. [2] *11 U.S.C. § 363(f)*. The trustee has had no contact with Chavez. Chevez did not respond to the [**4] motion. The trustee asserts that Chevez' silence is his consent to the sale under ***§ 363(f)(2)***. [3]

[**5] **Discussion**

*In re **Roberts**, 249 B.R. 152 (Bankr.W.D.Mich. 2000)* discusses the meaning of "consents" in ***§ 363(f)(2)***. In this case, the property was encumbered by four different liens. There was clearly no equity in the property. The trustee sought to sell the property with the consent of the first lienholder for far less than the first lienholder's lien. The second lienholder objected but withdrew his objection and consented to the sale when the first lienholder agreed to carve out a small portion of the sales proceeds for the benefit of the second lienholder. The third and fourth lienholders did not respond to the motion to sell. *Id. at 153-154*. The trustee and the first lienholder asserted that the failure of the third and fourth lienholders to object constituted their consent to the sale. The effect of the sale

[1] The trustee alleged that there was in intermediate transfer where the debtor and Chevez conveyed the house to the debtor and the other two defendants who then conveyed it solely to the other two defendants, all on the same day. The additional conveyance, while odd, is not relevant to the matters under consideration here.

[2] The trustee first unsuccessfully tried to amend the default order to provide that "any interest of [Chevez]. . . is void." The complaint before the court only alleged avoidance claims under the Bankruptcy Code and the Virginia Code. The only relief sought was avoidance of the transfers. There were no allegations supporting any alternative theory that would invalidate Chevez' interest in the house.

[3] Section 363(f) states:

> ***HN1*** The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if --
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

was that neither the third nor the fourth lienholder received any proceeds from the sale of the property, their liens were extinguished, and it was unnecessary to proceed under Michigan foreclosure law which provided a right of redemption. The court stated:

> There is no indication within Section 363 itself or its underlying legislative [**6] history that Congress intended "consents" to have any meaning other than that which it is commonly understood to have. "Consent," when used as a verb, means "to give assent or approval." Webster's Third New International Dictionary (unabridged) (1986).
>
> Trustee and [the first lienholder] have relied upon the legal artifice of implied consent to meet the requirement of Section 363(f)(2). However, their argument in reality is that "consents" and "fails to object" are synonymous. They are not. When a person consents to a particular action, that person has unequivocally manifested his or her affirmation of the proposed action through some discernible statement or act. In contrast, when a person fails to object to a proposed action, that person's affirmation can only [*468] be deduced from the lack of any statement or act which would suggest a contrary position. Obviously, such deductive reasoning always leaves open the possibility that the person's failure to object is attributable to some reason totally unrelated to that person's actual consent to the proposed act. For example, in the context of mass mailings to the creditor matrix, the person may have mistaken an important notice for junk [**7] mail and tossed it into the trash without even have read it.
>
> Had Congress substituted "does not object" for "consents" in Section 363(f)(2), there would be no question that the lienholder had the obligation to act if it did not want the property to be sold free and clear of its lien. However, the concept of consent (i.e., to give assent) imposes no such duty upon the lienholder. To the contrary, "consent" obligates the trustee to approach the lienholder and secure the lienholder's assent if the trustee wishes to sell the property free and clear of the lien.
>
> The Court recognizes that Congress intended to facilitate the administration of bankruptcy cases by permitting various activities to be pursued without an actual hearing provided that there was appropriate notice and an opportunity to be heard. The phrase "after notice and a hearing," which is interspersed throughout the Bankruptcy Code, including Section 363, contemplates this expedited procedure. 11 U.S.C. § 102(1)(B). However, Congress was quite specific as to what "after notice and a hearing" was to mean.. . .
>
> In other words, ***HN2*** Section 102(1)(B)(I) requires a party who opposes a proposed action to request [**8] a hearing. However, no such duty can be implied from the common meaning of the word "consent." If a party's consent is a prerequisite to proceeding with a proposed action, then that party should not have to request a hearing or otherwise object if it does not want the action to occur. Its silence should be sufficient.
>
> The Court suspects that the confusion as to what constitutes consent for purposes of Section 363(f)(2) is in part due to the requirement that all sales of estate property outside the ordinary course, including sales free and clear of liens, must be authorized by the court after notice and a hearing. 11 U.S.C. § 363(b). It is tempting to conclude that Section 363(b) imposes upon the lienholder the same obligation that any other party-in-interest has to come forward and object if it disagrees with a proposed sale. However, Sections 363(b) and 363(f) address entirely different issues. Sections 363(b) and (c) both dictate the circumstances under which the trustee is generally authorized to use or dispose of the estate's property. In contrast, Section 363(f) sets forth the circumstances under which the trustee may have the additional authority to sell [**9] the property free and clear to the purchaser.

Id. at 155-156. *See also* In re Silver, 338 B.R. 277, 280 (Bankr.E.D.Va. 2004); In re Takeout Taxi Holdings, Inc., 307 B.R. 525, 534 (Bankr.E.D.Va. 2004). [4]

HN3 The distinction between silence and consent is clear. Unless there is a duty to speak, silence signifies nothing. The Bankruptcy Code imposes no duty to respond to notices. The "notice and hearing" process permits the court to take certain actions if there is no objection. [*469] The procedure is necessary if any meaningful and

[4] Both *Silver* and *Takeout Taxi* were decided, quite independently of each other, on the same day.

timely administration of bankruptcy estates, either in liquidation or reorganization, is to be achieved. It assures that all necessary parties know what the proposed action is and that they are given an opportunity to participate. *11 U.S.C. § 102(1)*. That, though, is different from consent, an act affirmatively [**10] approving the proposed action. Had Congress intended silence to be consent in *§ 363(f)(2)*, it knew how to say so. It did not.

The trustee in this case, as did the trustee in ***Roberts***, argues that Chevez' failure to respond is consent under *§ 363(f)(2)*. He relies on 3 *Collier on Bankruptcy* P363.06[3] (15th ed. 2006) and *Pelican Homestead v. Wooten (In re Gabel), 61 B.R. 661 (Bankr.W.D.La. 1985)* as his authority for his proposition that silence is consent under *§ 363(f)(2)*. Collier states:

> ***HN4*** The trustee may sell property of the estate free of liens or other interests when the holder of the lien or interest consents to such a sale. This provision is similar to *section 9-315(a) of the Uniform Commercial Code* , which permits a sale free of a security interest when the secured party consents to such a sale. The consent required is consent to a sale free of liens or interests, not merely consent to sale of the assets. The consent may be express or may be implied from circumstances surrounding the sale.27

Footnote 27 states:

> *FutureSource LLC v. Reuters Ltd., 312 F.3d 281 (7th Cir. 2002),* [**11] *cert. denied, 538 U.S. 962, 123 S. Ct. 1769, 155 L. Ed. 2d 513 (2003)* (failure to object may constitute consent, if there was adequate notice); *Veltman v. Whetzal, 93 F.3d 517 (8th Cir. 1996)* (failure to object to proposed sale, coupled with agreement to stipulation on authorizing sale free of interest, constituted consent); *In re Elliot, 94 B.R. 343 (E.D.Pa. 1988)* (implied consent found); *Hargrave v. Township of Pemberton (In re Tabone, Inc.), 175 B.R. 855, 32 C.B.C.2d 1239 (Bankr.D.N.J. 1994)* (failure to object to notice of sale or attend hearing deemed consent to sale for purposes of *section 363*); *In re Shary, 152 B.R. 724 (Bankr.N.D.Ohio 1993)* (state's failure to object to transfer of liquor license constituted consent to sale). *Contra In re **Roberts**, 249 B.R. 152 (Bankr.W.D.Mich. 2000)*.

The text in Collier is an accurate statement of the law. ***HN5*** *Section 363(f)(2)* requires consent and that consent may be either express or implied. However, the cases cited in Collier, fn.27, and particularly the parentheticals used to describe the holdings in the cases, [**12] are not apt. They suggest that in addition to express or implied consent, silence is consent. It is this proposition -- that silence is consent -- upon which the trustee relies. He is mistaken.

The common denominator of the cases cited by Collier and relied upon by the trustee is their procedural posture. In each case, a sale free and clear of interests was approved by the bankruptcy court and the party who held the interest later sought to collaterally attack the free and sale order. ***HN6*** In a collateral attack of an order, the issue ought to be whether the order was void, not whether it was correct. *See Eberhardt v. Integrated Design & Constr., Inc., 167 F.3d 861, 870- 872 (4th Cir. 1999)*; *Schwartz v. United States, 976 F.2d 213, 217 (4th Cir. 1992)* (relief under *Fed.R.Civ.P. 60(b)(4)* available only if judgment is void, not because it is erroneous); *Baumlin & Ernst, Ltd. v. Gemini, Ltd., 637 F.2d 238, 242 (4th Cir. 1980)* (error by trial court not sufficient to vacate an order; only a voidable order may be attacked collaterally). It is, in a sense, not surprising that none of the cases cited [*470] relate [**13] to the hearing and decision on the motion to sell free and clear in the first instance. If the interested party appears at the hearing on the motion to sell and objects, it is fairly obvious he does not consent and that *§ 363(f)(2)* is not applicable. It is only when he is absent that the proponent of the motion must prove that the interested party in fact consents to the sale free and clear. If that factual finding is made but is erroneous, or the interested party simply does not like the outcome of the sale, his only remedy is to collaterally attack the order to sell free and clear. [5] While issues of service and notice may form the basis for such an attack, the correctness of the finding that he consented may not.

[**14] *FutureSource LLC v. Reuters Ltd., 312 F.3d 281 (7th Cir. 2002)* was such a collateral attack. It was a diversity suit, not a bankruptcy case. *Id. at 283*. It related to a bankruptcy case in which Bridge Information Services was the debtor. Two years before filing bankruptcy, Bridge and FutureSource entered into an Intercompany Service

[5] There are remedies under Fed.R.Bankr.P. 9023 and 9024 (***Fed.R.Civ.P. 59*** and ***60***), but the challenges are often long after the order was entered. The rules themselves impose tight constraints on relief.

Agreement (ISA). Bridge purchased news and financial data from Reuters. Under the ISA, Bridge sold consolidated, rearranged and reformatted financial-markets data to FutureSource and the software necessary to download it by FutureSource's customers. During Bridge's bankruptcy, it sold most of its assets to Reuters free and clear of all liens and interests. Neither the ISA nor Bridge's right to receive royalties from FutureSources under the ISA was included in the sale. These assets, the ISA and the right to receive royalties under the ISA, were later sold to a third party, Moneyline, which assumed the ISA. FutureSource asserted that it had a license to use Bridge's intellectual property and that license could not be extinguished by the sale of the underlying property. *Id. at 285*. The court found that FutureSource's [**15] interest, if any, was of the kind that could be sold under *§ 363(f)(2)*. Then it stated:

> It is true that the Bankruptcy Code limits the conditions under which an interest can be extinguished by a bankruptcy sale, but one of those conditions is the consent of the interest holder, and lack of objection (provided of course there is notice) counts as consent. It could not be otherwise; transaction costs would be prohibitive if everyone who *might* have an interest in the bankrupt's assets had to execute a formal consent before they could be sold.
>
> And in any event the order approving a bankruptcy sale is a judicial order and can be attacked collaterally only within the tight limits that *Fed.R.Civ.P. 60(b)* imposes on collateral attacks on civil judgments. FutureSource has made no effort to bring itself within those limits; and now that more than a year has passed since the order was issued, it is doubtful, to say the least, that FutureSource could succeed in such a collateral attack.

Id. at 285-286. (Italics in original)(internal citations omitted).

The essential holding was that FutureSource was too late. Whether [**16] the bankruptcy court's order to sell free and clear was right or wrong -- whether "lack of objection (provided of course there is notice)" was the proper standard or not -- the sale order was final and FutureSource could not collaterally attack it. Its remedy was to seek relief from the order, not to launch a collateral attack. The likelihood of the [*471] success or failure of the prospective *Rule 60(b)* motion did not change the impropriety of the collateral attack. [6]

[**17] *Veltman v. Whetzal, 93 F.3d 517 (8th Cir. 1996)* does not support the trustee because the court found, in dicta, that the co-owners consented to the sale of the property. Consent was given at various stages of the chapter 11 proceeding and later after the case had been converted to chapter 7. The actual holding was that they had failed to timely appeal. In addition, the properties had been sold and no stay pending appeal had been obtained. *See 11 U.S.C. § 363(m)*. Collier's parenthetical statement -- "failure to object to proposed sale, coupled with agreement to stipulation on authorizing sale free of interest, constituted consent" -- goes too far by mentioning the failure to object to the sale. The court found, independent of any failure to object, that consent arose from the co-owners' actual participation in the case in negotiating a stipulation permitting the sale of the properties during the chapter 11 phase of the case and their consent to the chapter 7 trustee selling the properties subject to the stipulation. [7] *Id. at 521*. The real issue was not the sale, but the distribution of the proceeds of sale. *Id.*

[**18] *In re Elliot, 94 B.R. 343 (E.D.Pa. 1988)* is also a case in which the affected lienholder filed a complaint to

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[6] ***HN7*** Under *§ 363(f)(2)* consent is required only of those with *actual* interests in the debtor's property. Whether all actual interests have been identified and dealt with in accordance with one of the five alternatives under § 363(f) is a factual question that must be resolved before a sale free and clear may be authorized. If there is doubt as to whether a party has an interest in the property to be sold, the parties frequently consent to the sale with interest, if any, attaching to the proceeds, thus preserving the status quo. If, however, the parties do not agree to the sale and the dispute as to the interest is a bona fide dispute, consent of the alleged interest holder is unnecessary. 11 U.S.C. § 363(f)(4). If the interest is a disputed lien, § 363(f)(3) is also available.

[7] The case presented a challenging scenario. The debtor and the co-owners owned 15 undeveloped lots which were apparently encumbered by a single mortgage. Undeveloped lots are more easily partitioned than a single house. Each co-owner can simply take sole ownership to the appropriate number of lots. The co-owners in this case requested the bankruptcy court to partition the lots. The problem was the mortgage. The bank would be paid from the first proceeds available. If the lots were partitioned, it became important who sold his lots first, especially since one of the parties was insolvent. The stipulation resolved these issues. It allowed the sale of lots with an agreed upon distribution of proceeds between the bank and the parties.

set aside a sale free and clear of liens after the sale was completed. Citicorp received notice of the proposed sale before the chapter 7 trustee's public auction and did not appeal the post-sale order confirming the sale. The bankruptcy court refused to set aside the sale. The district court affirmed, rejecting all of Citicorp's arguments. The district court stated:

> Citicorp consented to the sale by failing to make any timely objection after receiving notice of the sale. Citicorp contends that implied consent is insufficient to satisfy the consent requirement of § 363(f)(2). I disagree.

Id. at 345. The statement, however, is supported only by citing In re Gabel, 61 B.R. 661 (Bankr.W.D.La. 1985). It is not otherwise discussed. The proposition that consent may be implied is not in issue in the case before this court, only whether silence is implied consent. In Elliot, the issue was whether there were grounds to set the sale order aside. The opinion reflects [**19] none. If the bankruptcy court was factually wrong in construing silence as consent, Citicorp should have appealed the [*472] decision, not have attacked it collaterally later. When attacked collaterally, the issues are whether the bankruptcy court had jurisdiction to enter the order, whether the parties were properly before the court, whether the order was void, or whether there are equitable grounds to avoid the judgment. *See* Fed.R.Bankr.P. 9024 (incorporating Fed.R.Civ.P. 60). The issue is not whether the sale order was erroneous.

Hargrave v. Township of Pemberton (In re Tabone, Inc.), 175 B.R. 855 (Bankr.D.N.J. 1994) is interesting procedurally. The chapter 7 trustee sold the debtor's real estate free and clear of liens and distributed the proceeds to the various secured creditors which included the township. Later, the trustee discovered that the estate was administratively insolvent and sought, by utilizing § 724(b), to recover the money he had paid to the township for taxes. Section 724(b) permits a trustee to avoid certain tax liens. The recovery would then be available to pay the administrative [**20] expenses. The township objected, asserting among other reasons that the trustee did not have the authority to sell the property free and clear of liens. The bankruptcy court rejected this argument, noting that the trustee was authorized to sell the property free and clear of liens under § 363(f)(2) and (f)(3). With respect to § 363(f)(2) it stated that, "As the Township did not offer any objection, it may be deemed to have consented to the sale for purposes of section 363(f)(2)." Id. at 858. It then went on to find that § 363(f)(3) applied because the sale was for more than the aggregate value of all the liens. "We conclude that under either provision, the trustee was authorized to sell this property free and clear of all liens." Id. at 858. Section 363(f)(3) was clearly applicable and resolution of the § 363(f)(2) issue was unnecessary. In any event, the correctness of either the § 363(f)(2) or (f)(3) finding was irrelevant. The township in defending against the § 724 motion had to show that the sale order was void. It was not. The real issue was not the validity of the sale order, but whether the trustee was precluded from later seeking to [**21] avoid the township's lien. The propriety of the sale order was not in question, only its effect on the trustee's later § 724(b) avoidance action.

The last case cited is In re Shary, 152 B.R. 724 (Bankr.N.D.Ohio 1993). In this case the chapter 7 trustee was authorized to sell all of the debtor's assets free and clear of liens. One asset was a liquor license. The assets, including the liquor license, were sold and the sale confirmed without objection by the State of Ohio. The state would not transfer the liquor license because there were unpaid presale tax obligations. The trustee sought an order to compel the state to transfer the liquor license. The court stated:

> Having remained silent during the sale confirmation process, the State cannot be presently heard meritoriously in opposing the transfer of the liquor license. To the extent that the State may have possessed a valid security interest in any of the property sold, without a sustained objection, such interest was transferred to the proceeds of sale. Moreover, the State's failure to object to the sale, or the confirmation of the sale, implicitly conveyed its consent to the sale as found under § 363(f)(2). [**22]

Id. at 725. Once again, a sale free and clear of liens was authorized by the bankruptcy court and challenged afterwards. The thrust of the state's objection was not the sale itself, but that it had not been paid its presale taxes that were an encumbrance. As the court noted, the state's lien was transferred to the proceeds of sale. At this point, it was too late to collaterally attack the sale order and the [*473] court's comment that the state's failure to object

to the sale was dicta.

The trustee places uncritical reliance on the cases cited in Collier. When reviewed in context, the statements that silence is consent are dicta. Each case is ***HN8*** a collateral attack on a prior order of the court authorizing the sale free and clear of liens and interests. It is not enough to show that the court was factually wrong, that is, a party the court found consented to the sale did not consent to the sale. Instead, the party must show that it is entitled to relief from the erroneous order under Fed.R.Bankr.P. 9023 or 9024 which incorporate Fed.R.Civ.P. 59 and 60 [**23] or otherwise in a separate proceeding. [8]

The trustee also relies on *Pelican Homestead v. Wooten (In re Gabel), 61 B.R. 661 (Bankr.W.D.La. 1985)* which is generally relied upon the cases cited in Collier, fn. 27. There the lienholder sought to vacate the order to sell free and clear apparently under Fed.R.Civ.P. 59. The court found that the lienholder received proper notice of the proposed sale and was "estopped to deny its implied consent at this late stage." *Id. at 667*. There is little discussion of the issues: whether failure to object is [**24] consent; whether silence is implied consent; and whether the doctrine of estoppel was applicable. ***Roberts*** is more persuasive in its discussion of consent.

The trustee also presented a recent order entered by another judge of this court that recites that the failure to object to the motion was consent. *Thoroughbreds Grill & Brewing Co., LLC,* Case No. 06-10645-SSM (Bankr.E.D.Va. Aug. 11, 2006). The order, prepared by counsel [9] and entitled "Order Approving Bidding Procedures and Sale," recites the following finding:

> 9. The Trustee may sell the Debtor's assets free and clear of all interests of any kind or nature because, in each case, one or more of the standards set forth in §§ 363(f)(1)-(5), 105(a) and 365 of the Bankruptcy Code has been satisfied. Holders of interest in the debtor's assets who did not object to the sale are deemed to have consented pursuant to § 363(f)(2) of the Bankruptcy Code.

Id. Order, P9.

[**25] A review of this court's docket casts doubt on counsel's interpretation of the order. The order does not state ***which*** provision of § 363(f) is applicable. It only says that "one or more of the standards set forth in §§ 363(f)(1)-(5), 105(a) and 365 of the Bankruptcy Code has been satisfied." This leaves open which one was satisfied. Leaving aside §§ 105(a) and 365 which are not relevant to the motion before the court, the court's docket makes clear that § 363(f)(1), (3) and (5) were wholly inapplicable, leaving only § ***363(f)(2)*** and (4) as possible bases for the sale.

Thoroughbreds' petition was filed on June 20, 2006. The proposed sales price for the assets exceeded all scheduled liens except for two: Burke Homes Corporation for claims incurred from April to December 2005, and Burke Realty Capital LLC for claims incurred from August 26, 2005 to April 1, 2006. The claims were scheduled as $ 14,508.85 and $ 416,963.43, respectively. [*474] *Thoroughbreds Grill & Brewing,* Schedule D (Docket Entry 19). The answer to question 10 on the Statement of Financial Affairs reflects that there were transfers to Burke Homes Corporation and Burke [**26] Realty Capital LLC on May 30, 2006. The transfers were security interests encumbering all the debtor's assets. One member of the debtor is Brian C. Burke, Sr., who owns 71.46% of the debtor. *Id.* Statement of Financial Affairs, Question 10 (Docket Entry 19). He is the debtor's designee and signed the Schedules and the Statement of Financial Affairs.

The trustee filed an adversary proceeding on July 24, 2006, against Burke Homes Corporation, Burke Realty Capital LLC, and others. It seeks to recover preferences. It alleges that the two entities are insiders and that Burkes Realty Capital's financing statement was filed on June 19, 2006 -- the day before the filing of the petition -- and that Burke Homes' financing statement was filed on June 20, 2006 at 2:03 p.m. -- 3 1/2 hours after the filing of the petition.

It is readily apparent from the record that § 363(f)(4) is the applicable provision of § 363(f) for authorization of the sale free and clear. The Burke Homes and Burke Realty liens, the two in question, were the subject of a

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[8] There are ramifications arising from setting aside an order authorizing the sale of property. If the sale order is vacated or modified, provision should be made to protect the buyer and return the parties to the *status quo ante.* Section 363(m) protects a sale if the sale order is reversed or modified on appeal; however, a collateral attack is not an appeal and § 363(m) may not be applicable.

[9] The trustee and counsel in Thoroughbreds Grill & Brewing Co., are the same as in this case.

bona fide dispute. *11 U.S.C. § 363(f)(4)*. An adversary proceeding addressing them was pending when the court heard the motion [**27] to sell and when the sale order was entered.

The hearing on the motion to sell free and clear was held before another judge of this court and this judge is unaware of what evidence was taken or proffered or of the nature of the arguments made. No written opinion or transcript of the proceedings was presented by counsel to support his interpretation of the order. It is possible that the evidence supported the conclusion that Burke Homes and Burke Realty implicitly consented to the sale free and clear of their liens. In any event, since the order stated that at least one prong of *§ 363(f)* applied and *§ 363(f)(4)* clearly applies, whether ***§ 363(f)(2)*** was also applies is not material and the order presented by the trustee offers scant support for his proposition that silence is consent under ***§ 363(f)(2)***. [10]

[**28] The trustee argues in the alternative that the pending adversary proceeding which seeks to avoid what is now known to be a nonexistent transfer from the debtor to Chevez shows that there is a bona fide dispute under *§ 363(f)(4)*. There are, however, no allegations in the pending adversary proceeding that support any other relief and at the hearing counsel proffered none that were sufficient to raise a bona fide dispute.

Conclusion

The trustee's motion to sell free and clear will be denied because Chevez has not consented to the sale and there is no bona fide dispute as to his ownership interest in the property. Chevez' silence is not consent.

Alexandria, Virginia

September 22, 2006

/s/ Robert G. Mayer

United States Bankruptcy Judge

ORDER

THIS CASE was before the court on September 12, 2006, on the trustee's motion to approve a sale of certain real property free and clear of liens and encumbrances. For the reasons stated in the accompanying memorandum opinion; it is

ORDERED that the motion is denied.

DONE at Alexandria, Virginia, this 21st day of September, 2006.

/s/ Robert G. Mayer

United States Bankruptcy Judge

[10] As indicated above, there are two published opinions of this court holding that silence is not consent. *See In re Silver,* 338 B.R. 277, 280 (Bankr.E.D.Va. 2004) and *In re Takeout Taxi Holdings, Inc.,* 307 B.R. 525, 534 (Bankr.E.D.Va. 2004).

In re Roberts

United States Bankruptcy Court for the Western District of Michigan

May 22, 2000, Decided

Case No. HK 99-00569, Chapter 7

Reporter
249 B.R. 152; 2000 Bankr. LEXIS 560; 44 Collier Bankr. Cas. 2d (MB) 283; 36 Bankr. Ct. Dec. 52

In re: THOMAS A. ***ROBERTS***, f/d/b/a BARRY'S PARTY STORE, f/d/b/a PRINCE'S MARKET, Debtor.

Subsequent History: [**1] Counsel and Opinion Amended May 24, 2000.

Disposition: Trustee's proposed sale of the Property free and clear of all liens and encumbrances denied.

Core Terms

lienholder, free and clear, notice, Trustee's, liens, consents, cases, fail to object, proposed sale, authorize, collateral, foreclosure, selling property, surcharge, objected, assent, rights, estate property, circumstances, redemption, purposes, entity, carve

Case Summary

Procedural Posture
Chapter 7 trustee filed a motion to sell property of the estate free and clear of liens under *11 U.S.C.S. § 363(f)(2)*. Two lienholder creditors consented. Senior lienholder creditor agreed to provide the trustee and the other consenting lienholder creditor "carve outs" from funds received from the sale. There was no equity in the property. Two lienholder creditors did not consent, and did not object.

Overview
Although there was no equity in the property, Chapter 7 trustee moved to sell the estate property free and clear of liens under *11 U.S.C.S. § 363(f)(2)*. Two lienholder creditors consented. Senior lienholder creditor agreed to provide trustee and the other consenting lienholder creditor "carve outs" from funds received from the sale. Two lienholder creditors failed to consent or object. The court found senior lienholder creditor's reason for making the carve out arrangement was to avoid the much lengthier state foreclosure process. Denying the motion to sell free and clear of all liens sua sponte, the court held that the consent required by *11 U.S.C.S. § 363(f)(2)* could not be implied from the lienholder's failure to object to a trustee's motion to sell property of the estate free and clear of a lien. Consent and failure to object were not synonymous. The trustee was authorized to sell the property free and clear of only the liens of the consenting lienholder creditors, since they were the only lienholders who actually gave their consent to the sale.

Outcome
Trustee's motion to sell the estate property free and clear of all liens and encumbrances was denied. The court authorized the sale free and clear of only the liens of the consenting lienholder creditors, since they were the only lienholders who actually gave their consent to the sale. Failure of other lienholder creditors to object was not consent to the sale.

LexisNexis® Headnotes

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN1 A bankruptcy trustee may sell property of the estate free and clear of a lien if the lienholder consents. *11 U.S.C.S. § 363(f)(2)*.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN2 The consent required by *11 U.S.C.S. § 363(f)(2)* may not be implied from the lienholder's failure to object to a trustee's motion to sell property of the estate free and clear of a lien.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN3 See *11 U.S.C.S. § 363(f)*.

Governments > Legislation > Interpretation

HN4 "Consent," when used as a verb, means to give assent or approval.

Governments > Legislation > Interpretation

HN5 "Consents" and "fails to object" are not synonymous. When a person consents to a particular action, that person has unequivocally manifested his or her affirmation of the proposed action through some discernable statement or act. In contrast, when a person fails to object to a proposed action, that person's affirmation can only be deduced from the lack of any statement or act which would suggest a contrary position.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Governments > Legislation > Interpretation

HN6 "Consent," as used in *11 U.S.C.S. § 363(f)(2)*, obligates the trustee to approach the lienholder and secure the lienholder's assent if the trustee wishes to sell the property free and clear of the lien.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Case Administration > Notice

HN7 Congress intended to facilitate the administration of bankruptcy cases by permitting various activities to be pursued without an actual hearing provided that there was appropriate notice and an opportunity to be heard. The phrase "after notice and a hearing," which is interspersed throughout the Bankruptcy Code, including *11 U.S.C.S. § 363*, contemplates this expedited procedure. *11 U.S.C.S. § 102(1)(B)*. However, Congress was quite specific as to what "after notice and a hearing" was to mean.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Procedural Matters > Contested Matters

HN8 See *11 U.S.C.S. § 102(1)*.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Bankruptcy Law > Procedural Matters > Contested Matters

HN9 *11 U.S.C.S. § 102(1)(B)(i)* requires a party who opposes a proposed action to request a hearing. However, no such duty can be implied from the common meaning of the word "consent" as used in *11 U.S.C.S. § 363(f)(2)*. If a party's consent is a prerequisite to proceeding with a proposed action, then that party should not have to request a hearing or otherwise object if it does not want the action to occur. Its silence should be sufficient.

Bankruptcy Law > Administrative Powers > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN10 All sales of estate property outside the ordinary course, including sales free and clear of liens, must be authorized by the court after notice and a hearing. *11 U.S.C.S. § 363(b)*.

Bankruptcy Law > Administrative Powers > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN11 *11 U.S.C.S. § 363(b)*, *(f)* address entirely different issues. *11 U.S.C.S. § 363(b)*, *(c)* both dictate the circumstances under which the trustee is generally authorized to use or dispose of the estate's property. In

contrast, 11 U.S.C.S. § 363(f) sets forth the circumstances under which the trustee may have the additional authority to sell the property free and clear to the purchaser.

Bankruptcy Law > Administrative Powers > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Bankruptcy Law > Case Administration > Notice

HN12 Nothing within 11 U.S.C.S. § 363(b) prevents the bankruptcy trustee from selling encumbered estate property outside the ordinary course subject to those encumbrances, provided that proper notice is given and no party-in-interest (including any lienholder) makes a timely request for a hearing. However, if the trustee wishes to sell the property free and clear of those encumbrances, then the trustee must not only secure court authority under § 363(b), but also must secure the affected lienholder's consent or meet one of the requirements of 11 U.S.C.S. § 363(f).

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

HN13 See 11 U.S.C.S. § 363(c)(2).

Bankruptcy Law > Administrative Powers > Adequate Protection

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

HN14 Congress's juxtaposition of the word "consents" and the phrase "after notice and a hearing" in 11 U.S.C.S. § 363(c)(2) establishes beyond doubt that these are two separate and distinct concepts. Put simply, a trustee is authorized to use in the ordinary course a creditor's cash collateral if either the lienholder consents or the court authorizes the use after notice and a hearing. Indeed, the court may authorize the use of the creditor's cash collateral even if the creditor affirmatively indicates that it is withholding its consent (i.e., the creditor objects) if the creditor can be adequately protected. 11 U.S.C.S. § 363(e).

Bankruptcy Law > Administrative Powers > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Contracts Law > Types of Commercial Transactions > Secured Transactions > General Overview

Contracts Law > ... > Default > Foreclosure & Repossession > Dispositions of Collateral

HN15 11 U.S.C.S. § 363(c)(2), like the remaining portion of 11 U.S.C.S. § 363(b), (c), concerns the circumstances under which the trustee has authority to use estate property. While § 363(c)(2) may permit the trustee to use a creditor's cash collateral over the creditor's objection, § 363(c)(2) does not authorize the trustee to sell that cash collateral free and clear of a creditor's lien. That authority must be based upon 11 U.S.C.S. § 363(f).

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN16 See 11 U.S.C.S. § 363(f).

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Civil Procedure > Judgments > Relief From Judgments > Altering & Amending Judgments

HN17 11 U.S.C.S. § ***363(f)(2)*** by its very terms does not require a lienholder to actually object to a sale in order to withhold its consent to the sale free and clear of its lien. However, if the creditor does not object and if it also does not file a motion to modify the sale order within the time prescribed by Fed. R. Bankr. P. 9023, the creditor is effectively barred from later objecting to the improperly granted order. In other words, the rules and policies which favor the finality of orders compel the secured creditor to object to a sale free and clear of its lien notwithstanding the fact that 11 U.S.C.S. § ***363(f)(2)*** imposes no such duty to do so.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

Contracts Law > ... > Default > Foreclosure & Repossession > Dispositions of Collateral

HN18 A bankruptcy court's own notions as to appropriate policy should not affect its interpretation of the unambiguous language contained in *11 U.S.C.S. § 363(f)(2)*.

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > General Overview

Bankruptcy Law > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interest

HN19 *11 U.S.C.S. § 363(f)(2)* specifically requires each lienholder's consent before property may be sold free and clear of its lien.

Counsel: Alexander C. Lipsey, Esq., Chapter 7 Trustee.

Eric Lund, Esq., for Huntington Bank.

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Judges: Honorable Jeffrey R. Hughes, United States Bankruptcy Judge.

Opinion by: Jeffrey R. Hughes

Opinion

[*153] ***HN1*** A trustee may sell property of the estate free and clear of a lien if the lienholder consents. *11 U.S.C. § 363(f)(2)*. The question before the Court is whether a lienholder's consent may be implied if the lienholder does not object to the proposed sale after appropriate notice. The Court concludes that ***HN2*** the consent required by *Section 363(f)(2)* [1] may not be implied from the lienholder's failure to object. The lienholder must actually give its assent.

I. BACKGROUND

[2]** The Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on January 26, 1999. The Chapter 7 estate includes a parcel of real property located in Milton Township, Cass County, Michigan (the "Property"). The Property is encumbered by at least four different liens. The lienholders of record are Huntington National Bank N.A. ("Huntington"), Barry E. and Patricia A. Mead (the "Meads"), Harjit Singh Dhillon (a/k/a Hargit Dihlon Singh) ("Dhillon"), [2] and the C.A. Murphy Oil Company, Inc. ("Murphy Oil").

The Chapter 7 Trustee, Alexander C. Lipsey ("Trustee"), entered into a buy-sell agreement with R.M.J. Corp. of Indiana to purchase the Property from the bankruptcy **[**3]** estate for $ 125,000.00. On March 21, 2000, Trustee filed his motion requesting the Court to authorize the proposed sale. The motion also requests that the Property be sold free and clear of all liens, including the lien of Huntington, the Meads, Dhillon and Murphy Oil.

According to the motion, Huntington holds the first priority lien in the Property. Huntington's lien secures a claim against the Debtor in excess of $ 230,000. The motion did not disclose the amounts owed to the other lienholders. Nonetheless, it is clear that the bankruptcy estate has no equity in the Property and the Trustee concedes as much.

Trustee's incentive for selling property with no apparent value to the estate is a side agreement with Huntington whereby Huntington will turn over $ 5,000 from the proceeds it anticipates receiving from the sale as a "carve out" for the benefit of the estate. Huntington's reason for making this arrangement is presumably to avoid the necessity of having to eliminate the interests of the junior lienholders through the much lengthier state foreclosure process. [3]

[4]** [*154]** Trustee served the sale motion upon all creditors, including the Meads, Dhillon and Murphy Oil.

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[1] For purposes of this opinion, "Section __" shall mean the pertinent section of the Bankruptcy Code, ***11 U.S.C. §§ 101 et seq.***

[2] Trustee's motion indicates that there is some confusion as to Dhillon's actual name ("Harjit Singh Dhillon" or "Hargit Dihlon Singh") and his current address. For purposes of its decision, the Court has assumed that Dhillon received proper notice of the Trustee's motion to sell the Property free and clear of his lien.

[3] Under Michigan law, a senior lienholder must foreclose junior liens and other interests through a court supervised proceeding unless foreclosure is permitted through advertisement. M.C.L.A. §§ 600.3101 *et seq.* and 600.3201 *et seq.* The culmination of the foreclosure is the

The notice which accompanied the motion indicated that the Court would hear the Trustee's motion on April 20, 2000. The notice also directed any party-in-interest who wished to respond to the proposed sale to file its response in writing with the clerk's office for this Court no later than three business days before the April 20, 2000 hearing date.

Trustee presented his motion to the Court at the April 20, 2000 hearing and Huntington appeared in support. The Meads filed a timely response objecting to the sale and appeared at the hearing. However, the Trustee and Huntington advised the Court at the hearing that the Meads' objection had been resolved by Huntington's agreeing to carve out another $ 10,000.00 from its anticipated distribution for the benefit of the Meads. The Meads have now withdrawn their objection.

Dhillon and Murphy Oil did not file responses. Nor did they appear at the April 20, 2000 hearing. When asked by the Court whether Dhillon and Murphy Oil had given their assent to the proposed sale, the Trustee reported that they had not. Instead, the Trustee took the position **[**5]** that both of these lienholders had implicitly consented to the sale of the Property free and clear of their interests because of their failure to object to the sale in writing or to otherwise appear in opposition at the April 20, 2000 hearing. Neither the Trustee nor Huntington offered any basis other than this implied consent under *Section 363(f)(2)* as authority to sell the Property free and clear of Dhillon's and Murphy Oil's liens.

II. JURISDICTION

The Court has jurisdiction over the Trustee's proposed sale pursuant to 11 U.S.C. § 1334(a) and L. Civ. R. 83.2 (W.D. Mich.). This matter is a core proceeding and therefore the Court's decision is a final order subject to review under Section 158 of Title 28. *28 U.S.C. §§ 157(b)(1)* and *157(b)(2)(N)*. The following sets forth the Court's conclusions of law as required by *Rules 7052* and *9014 of the Federal Rules of Bankruptcy Procedure*. In making these conclusions, the Court has relied upon the Trustee's motion to sell the Property in question together with the documents filed in support of that motion. The Court has also considered the brief filed by Huntington in support of Trustee's **[**6]** motion. There were no contested facts which required a finding by this Court.

III. DISCUSSION

For purposes of this decision, the Court assumes as true all of the pertinent information contained in Trustee's motion. Specifically, the Court assumes that Huntington in fact holds a valid, first priority lien in the Property, that Huntington's debt secured by that lien is substantially in excess of the value of the Property, and that both Dhillon and Murphy Oil received proper notice of the Trustee's intention to sell this Property free and clear of their liens. The question which the Court now decides is simply whether Dhillon's and Murphy Oil's failure to appear or otherwise object to the proposed sale is the equivalent of "consent" under *Section 363(f)(2)* so as to authorize the sale free and clear of their liens as proposed.

HN3 *Section 363(f)* reads as follows:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, **only if** -
>
> (1) applicable non bankruptcy law permits sale of such property free and clear of such interest; **[*155]**
>
> (2) **such entity consents;** [**7]
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). (Emphasis added).

There is no indication within *Section 363* itself or its underlying legislative history that Congress intended "consents" to have any meaning other than that which it is commonly understood to have. ***HN4*** "Consent," when

public sale of the property. In most instances, the senior lienholder is the successful bidder since there are few third parties who are willing to pay fair value for property subject to these redemption rights. Thereafter, the junior lienholders are given an additional period of time (anywhere between one month and one year) to redeem the property from the successful bidder. ***M.C.L.A. §§ 600.3140*** and ***600.3240***.

used as a verb, means "to give assent or approval." *Webster's* Third New International Dictionary (unabridged) (1986).

Trustee and Huntington have relied upon the legal artifice of implied consent to meet the requirement of Section 363(f)(2). However, their argument in reality is that ***HN5*** "consents" and "fails to object" are synonymous. They are not. When a person consents to a particular action, that person has unequivocally manifested his or her affirmation of the proposed action through some discernable statement or act. In contrast, when a person fails to object to a proposed [**8] action, that person's affirmation can only be deduced from the lack of any statement or act which would suggest a contrary position. Obviously, such deductive reasoning always leaves open the possibility that the person's failure to object is attributable to some reason totally unrelated to that person's actual consent to the proposed act. For example, in the context of mass mailings to the creditor matrix, the person may have mistaken an important notice for junk mail and tossed it into the trash without even have read it.

Had Congress substituted "does not object" for "consents" in Section 363(f)(2), there would be no question that the lienholder had the obligation to act if it did not want the property to be sold free and clear of its lien. However, the concept of consent (*i.e.*, **to give assent**) imposes no such duty upon the lienholder. To the contrary, ***HN6*** "consent" obligates the trustee to approach the lienholder and secure the lienholder's assent if the trustee wishes to sell the property free and clear of the lien.

The Court recognizes that ***HN7*** Congress intended to facilitate the administration of bankruptcy cases by permitting various activities to be pursued without an [**9] actual hearing provided that there was appropriate notice and an opportunity to be heard. The phrase "after notice and a hearing," which is interspersed throughout the Bankruptcy Code, including Section 363, contemplates this expedited procedure. 11 U.S.C. § 102(1)(B). However, Congress was quite specific as to what "after notice and a hearing" was to mean. ***HN8*** Section 102(1) states that:

> (1) "After notice and a hearing," or a similar phrase -
>
> (A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but
>
> (B) authorizes an act without an actual hearing if such notice is given properly and if --
>
> (i) **such a hearing is not requested** timely by a party in interest; or
>
> (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act[.]
>
> * * *

11 U.S.C. § 102(1). (Emphasis added).

In other words, ***HN9*** Section 102(1)(B)(i) requires a party who opposes a proposed action to request a hearing. However, no such duty can be implied from the [**10] common meaning of the word "consent." If a party's consent is a prerequisite to proceeding with a proposed action, then that party should not have to request a hearing or [*156] otherwise object if it does not want the action to occur. Its silence should be sufficient.

The Court suspects that the confusion as to what constitutes consent for purposes of Section 363(f)(2) is in part due to the requirement that ***HN10*** all sales of estate property outside the ordinary course, including sales free and clear of liens, must be authorized by the court after notice and a hearing. 11 U.S.C. § 363(b). It is tempting to conclude that Section 363(b) imposes upon the lienholder the same obligation that any other party-in-interest has to come forward and object if it disagrees with a proposed sale. However, ***HN11*** Sections 363(b) and 363(f) address entirely different issues. Sections 363(b) and (c) both dictate the circumstances under which the trustee is generally authorized to use or dispose of the estate's property. In contrast, Section 363(f) sets forth the circumstances under which the trustee may have the additional authority to sell the property free and clear to the purchaser.

Although a sale of estate [**11] property free and clear of liens may be desirable, it is not necessary. ***HN12*** Nothing within Section 363(b) prevents the trustee from selling encumbered estate property outside the ordinary course subject to those encumbrances, provided that proper notice is given and no party-in-interest (including any lienholder) makes a timely request for a hearing. However, if the trustee wishes to sell the property free and clear of those encumbrances, then the trustee must not only secure court authority under Section 363(b), but also must secure

the affected lienholder's consent or meet one of the requirements of Section 363(f).

Section 363(c)(2) well illustrates Congress's clear intention to distinguish between securing authority based upon notice and an opportunity to be heard and securing authority based upon consent. That section states that:

> ***HN13*** (2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless -
>
> (A) each entity that has an interest in such cash collateral consents; or
>
> (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

11 U.S.C. § 363 [**12] (c)(2).

Congress clearly envisioned two distinct scenarios when it enacted this subsection. The trustee may negotiate a cash collateral arrangement with the affected lienholders. If all of the lienholders consented (*i.e.*, gave their assent), the proposed use would be authorized without any intervention by the court. However, Congress also recognized that a debtor's post-petition cash needs can be both significant and immediate. If a creditor's consent were the only way a trustee could secure the requisite authority to use that creditor's cash collateral, then an obdurate creditor could hold the trustee hostage. Therefore, Congress provided the trustee with the alternative method of notifying all of the affected lienholders and giving them the opportunity to be heard if they objected.

HN14 Congress's juxtaposition of the word "consents" and the phrase "after notice and a hearing" in Section 363(c)(2) establishes beyond doubt that these are two separate and distinct concepts. Put simply, a trustee is authorized to use in the ordinary course a creditor's cash collateral if either the lienholder consents **or** the court authorizes the use after notice and a hearing. Indeed, the [**13] court may authorize the use of the creditor's cash collateral even if the creditor affirmatively indicates that it is withholding its consent (*i.e.*, the creditor objects) if the creditor can be adequately protected. 11 U.S.C. § 363(e). [4]

[**14] [*157] Huntington argues that every published opinion and the leading bankruptcy treatises support the Trustee's and its contention that the consent required by Section ***363(f)(2)*** may be implied by the lienholders' failure to object after notice. *See,* City Corp. Homeowners Services, Inc. v. Elliott (In re Elliott), 94 B.R. 343, 345-46 (E.D. Pa. 1988); In re James, 203 B.R. 449, 453-54 (Bankr. W.D. Mo. 1997); Hargrave v. Township of Pemberton (In re Tabone, Inc.), 175 B.R. 855, 858 (Bankr. D. N.J. 1984); In re Shary, 152 B.R. 724, 725-26 (Bankr. N.D. Ohio 1993); Pelican Homestead v. Wooten (In re Gabel), 61 B.R. 661, 667 (Bankr. W.D. La. 1985); *Lawrence P. King, et al.*, 3 Collier on Bankruptcy P 363.06[3] at 363-45, 46 (15th Ed. 1999); *William L. Norton, Jr.*, 2 Norton Bankr. L & Prac.2d § 37.22 n. 40 (1999 suppl.). The Court agrees that these cases and treatises support Huntington's and the Trustee's position. However, the Court chooses not to follow these authorities for the reason that they offer no good rationale for ignoring the clear language of Section 363(f).

Most of the cited authorities [**15] offer nothing more than the conclusory statement that consent may be implied and one or more citations to support that proposition. For example, the Norton treatise cites without critical analysis three of the cases cited above, *In re James, In re Elliott* and

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[4] The Court would note that Section 363(c)(2) is consistent with the dichotomy between Sections 363(b) and (c) and Section 363(f) which the Court has already discussed. ***HN15*** Section 363(c)(2), like the remaining portion of Section 363(c) and Section 363(b), concerns the circumstances under which the trustee has authority to use estate property. While Section 363(c)(2) may permit the trustee to use a creditor's cash collateral over the creditor's objection, Section 363(c)(2) does not authorize the trustee to sell that cash collateral free and clear of a creditor's lien. That authority must be based upon Section 363(f).

> ***HN16*** The trustee may sell property under subsection (b) **or (c)** of this section free and clear of any interest in such property of an entity other than the estate, only if --
>
> * * *

11 U.S.C. § 363(f). (Emphasis added)

In re Shary. These three cases in turn cite other cases for the same proposition but offer no independent analysis of their own. In fact, when the genealogy of all these authorities is completed, it turns out that the common ancestor for all of these cases and treatises is *In re Gabel, supra.*

The apposite language in *Gabel* is as follows:

> Having previously determined that Pelican was properly noticed, I need now only decide if this failure to object, according to the clear terms of the notice, should be viewed as "consent" within the meaning of Section 365(f)(2). My own reading of the law and the jurisprudence in this area leaves me with the firm belief that this is exactly the legal effect that must be given to such a failure to object. Indeed I find the case law to be replete with examples of courts finding consent based upon such facts; to cite but a few: *In re Torchia, 188 F. 207*; **[**16]** *In re Tele-Tone Radio Corporation, etc., 133 F. Supp. 739*; *In re Pioneer Sample Book Company, 374 F.2d 953*; *In re Hotel Associates, Inc., 6 B.R. 108*. Some courts have recently pointed out that under the new rules where there is a failure to object, no further court blessing of the sale is required as the trustee is empowered, by that fact alone, to act. *In re Hanline, 8 B.R. 449 (B.C.N.D. Ohio 1981)*; *In re Frank Meador Buick, Inc., 8 B.R. 450 (B.C.W.D. Va. 1981)*. Reiterating, I find that Pelican is estopped to deny its implied consent at this late stage. Accordingly, I find that the trustee's sale has complied with the provisions of *Section 363(f)*.

In re Gabel, 61 B.R. at 667.

Gabel, however, is not directly on point. The court in that case certainly stated that a secured creditor's consent for purposes of *Section 363(f)(2)* may be implied from the creditor's failure to object to the proposed sale. However, the court made this observation almost a year after the sale had been closed based upon a free and clear order issued by that very same court. What the court finally found **[**17]** was that "Pelican **[*158]** is **estopped** to deny its implied consent **at this late stage**." *Id.* (Emphasis added).

In the instant case, this Court is not confronted with the problem of having to set aside a sale order which has already been consummated. Rather, the Court itself has raised this issue before any order was entered. [5] One can only speculate how the court in *Gabel* would have decided the issue had it not been burdened by a previously issued order upon which a third party purchaser had clearly relied.

[18]** Moreover, the cases upon which the court in *Gabel* relied in reaching its conclusion that the consent required by *Section 363(f)(2)* may be implied have nothing to do with sales of estate property. The cases instead addressed the question of whether the trustee could surcharge its expenses against proceeds realized from the sale of a secured creditor's collateral over the secured creditor's objection. Indeed, three of the four cases cited by the court in *Gabel* were old Bankruptcy Act cases and therefore did not even address the issue in the context of the current Bankruptcy Code and its comprehensive scheme.

Section 506(c), which is the current codification of a trustee's authority to surcharge, offers no support for the conclusion that Congress intended the failure to object to substitute for consent when it enacted *Section 363(f)(2)*. Nowhere within Section 506(c) does the word "consent" appear. In sharp contrast, Congress not only used the word "consent" when it enacted *Section 363(f)(2)*, but is also contrasted that word with the separate concept of "after notice and a hearing" in the very same section. Therefore, reliance on cases interpreting Section 506(c) are not very **[**19]** persuasive and cases addressing pre-Code surcharges are even less persuasive.

Moreover, other case law interpreting Section 506(c) suggests that a secured creditor's consent to a Section 506(c) surcharge may not be implied from that creditor's

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[5] The Court believes that it is quite appropriate for it to have raised this issue *sua sponte*, particularly in light of the conclusion reached in *In re Gabel*. The secured creditor is caught in a virtual catch-22. As already noted, ***HN17*** Section *363(f)(2)* by its very terms does not require a lienholder to actually object to a sale in order to withhold its consent to the sale free and clear of its lien. However, if the creditor does not object and if it also does not file a motion to modify the sale order within the time prescribed by Fed. R. Bankr. P. 9023, the creditor is effectively barred from later objecting to the improperly granted order. In other words, the rules and policies which favor the finality of orders compel the secured creditor to object to a sale free and clear of its lien notwithstanding the fact that Section *363(f)(2)* imposes no such duty to do so. While in most instances the Court will defer to the actual parties-in-interest as to when and how bankruptcy laws are to be enforced in a specific case, the Court has no compunction interceding in this instance, particularly given the fact that property rights are affected by the proposed sale.

failure to object. For example, the Second Circuit limited a secured creditor's "implied" consent to the imposition of a surcharge to those instances where the creditor actually caused in some way the expense to be incurred. *General Electric Credit Corporation v. Peltz (In re Flagstaff Food Service Corp.), 762 F.2d 10, 12 (2nd Cir. 1985)*. Similarly, the Eighth Circuit upheld the bankruptcy court's imposition of a surcharge against the secured creditor based upon its conclusion that the creditor had actually consented to the debtor's continued operation in the Chapter 11 proceeding. *U.S. v. Boatmen's First National Bank of Kansas City, 5 F.3d 1157, 1160 (8th Cir. 1993) overruled by In re Hen House Interstate, Inc., 177 F.3d 719 (8th Cir. 1999), and cert. granted, 120 S. Ct. 444, 145 L. Ed. 2d 361 (1999). See also, Schindler v. Sharak (In re Salzman), 83 B.R. 233, 240 (Bankr. S.D.N.Y. 1988)* **[**20]** (holding that a secured creditor's consent to a surcharge could not be implied even when the secured creditor had not only supported the trustee's sale of its collateral but also had expressly consented to the sale free and clear of its lien). **[*159]** ***HN18***

The Court's own notions as to appropriate policy should not affect its interpretation of the unambiguous language contained in *Section 363(f)(2)*. However, the Court does observe that its decision addresses what would appear to be a concerted effort by Huntington to circumvent the Michigan foreclosure laws concerning real property. The Trustee does not claim any equity in the Property. Indeed, based upon Trustee's motion, it would appear that the value of the Property is substantially less than what is owed to Huntington. Yet Huntington has agreed to "carve out" $ 5,000 from the anticipated sale for the estate's benefit.

Obviously, Huntington has not offered this money to the Trustee out of a sense of charity. In effect, what Huntington is doing is purchasing the estate's *Section 363(f)* powers so as to forego the time and expense required to foreclose Dhillon's and Murphy Oil's liens through a state proceeding. Under Michigan law, Huntington **[**21]** would have had to sell the Property through either a judicial or non-judicial proceeding and then allow the applicable redemption period to expire before the Property would be free and clear of all liens. Based upon the Court's own experience, such a process would normally take at least eight months. It is not surprising that Huntington would prefer a *Section 363(f)* sale to this alternative, particularly when a buyer is immediately available.

However, the Michigan legislature created the redemption rights attendant to a foreclosure sale for a purpose. A foreclosure sale, by its very nature, is not necessarily the best reflection of a mortgaged property's real value. Redemption rights at least partially offset this problem by giving all junior lienholders (as well as the fee owner) some period of time to redeem the property at the price paid at foreclosure. While it may be true that junior lienholders seldom exercise their redemption rights, this Court cannot ignore the fact that these rights would be eliminated in situations such as the instant case.

The Court does not mean to suggest that Huntington's effort to avoid the Michigan foreclosure laws through this proposed sale was in **[**22]** bad faith. However, given that ***HN19*** *Section 363(f)(2)* specifically requires each lienholder's consent before property may be sold free and clear of its lien, the Court is constrained to deny approval of Trustee's sale of the Property as proposed.

The Court would also note that its decision does not altogether bar Huntington from expediting the state foreclosure process. Nothing prohibits Huntington from seeking out Dhillon or Murphy Oil and negotiating a "carve out" with them much as it did with the Meads and the Trustee. In fact, if one assumes that Huntington would have bought out Dhillon or Murphy Oil if either objected in the same manner it bought out the Meads when they objected, then even further doubt is cast upon Huntington's assertion that Dhillon's and Murphy Oil's consent can be implied from their failure to object. Had Huntington or the Trustee disclosed in the notice of sale that Huntington would be willing to negotiate a carve out with any lienholder who withheld its consent, the Court suspects that Dhillon and Murphy Oil might have been more aggressive in expressing their views concerning the sale.

IV. CONCLUSION

For the reasons stated in this opinion, Trustee's **[**23]** proposed sale of the Property free and clear of **all** liens and encumbrances is denied. The Court will approve the sale free and clear of only the liens of Huntington and the Meads since they were the only lienholders who actually gave their consent under *Section 363(f)(2)*. The Court will enter a separate order.

Dated: May 22, 2000

Honorable Jeffrey R. Hughes

United States Bankruptcy Judge

ORDER DENYING TRUSTEE'S MOTION FOR ORDER APPROVING SALE FREE AND CLEAR OF LIENS AND OTHER INTERESTS PURSUANT TO 11 U.S.C. § 363(f)(2)

At a session of said Court of Bankruptcy, held in and for said district on MAY 22 2000.

PRESENT: HONORABLE JEFFREY R. HUGHES

United States Bankruptcy Judge

Trustee having filed his motion to sell certain property located at 2205 U.S. 12 East, Niles, Michigan; a hearing having been held and the Court taking the matter under advisement; and the Court being otherwise fully advised in the premises.

NOW, THEREFORE, for the reasons set forth in the Court's separate written opinion, the Trustee is authorized under *11 U.S.C. § 363(b)* to sell the property described in his motion. However, [**24] the property may be sold free and clear of **only** the liens held by Huntington National Bank and Barry and Patricia Mead.

IT IS FURTHER ORDERED that if the Trustee wishes to proceed with the sale of the property as authorized by this order, he may submit a revised sales order consistent with this order.

IT IS FURTHER ORDERED that a copy of this order be served by United States first-class mail, postage prepaid, upon Robert J. Pleznac, attorney for the Debtor, Alexander C. Lipsey, Chapter 7 Trustee, Eric Lundford, Esq., attorney for Huntington National Bank, and Christopher J. Lynch, Esq., attorney for Barry E. and Patricia A. Mead.

5/22/00

Honorable Jeffrey R. Hughes

United States Bankruptcy Judge