Supreme Court Casts a Wide Net for Actual Fraud Under § 523: *Husky* and Its Potential Impact

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Mush, Mush! How Far Can *Husky* Carry the Concept of Nondischargeable Fraud?

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Insights and Issues From Pre-*Husky* And Post-*Husky* Case Law About the Possible Application of *Husky* To Future Nondischargeability Cases

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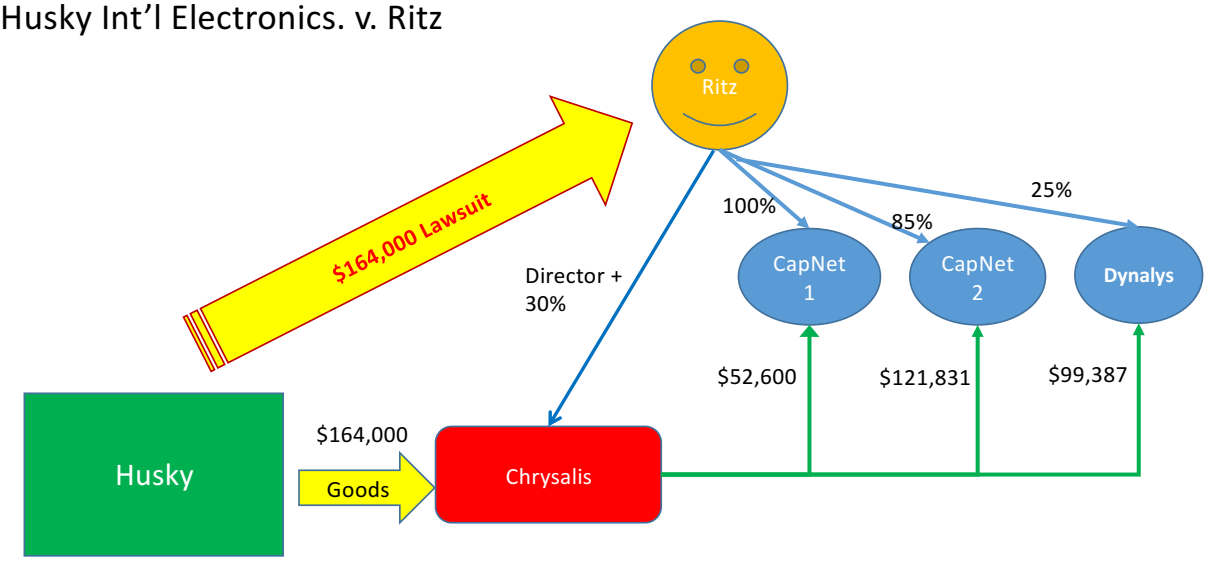
Husky Int'l Elects. v. Ritz, 136 S.Ct. 1581 (2016)

- ***Facts:***
- Husky sells $164,000 of electronic parts to Chrysalis
- Chrysalis is 30% owned by one of its directors, Ritz
- Ritz, during the time Chrysalis is incurring debt to Husky, causes Chrysalis to transfer larges sums to entities that Ritz owns in whole orin part
- Husky sues Ritz on the $164,000 debt
  - Alleges Ritz was liable for Chrysalis' debts under Texas statute
  - Ritz files for relief under chapter 7
  - Husky seeks to establish Ritz owes Husky the money, and that the debt is nondischargeable under "actual fraud" exception to discharge of § 523(a)(2)

Husky Int'l Electronics. v. Ritz



Husky Int'l Elects. v. Ritz, *136 S.Ct. 1581 (2016)*

- ***Court's Analysis***:
- Court first notes that Husky seeks to have Ritz's behavior characterized as "actual fraud"
- "Actual fraud" was an addition to 1978 Code. Under 1898 Act, only "false pretenses or false representations" were included
- Court acknowledges under *Field v. Mans*, this language meant the "elements that the common law . . . defined"

Husky, Continued

- Court states that "actual fraud" meant "any fraud that 'involv[es] moral turpitude or intentional wrong.'"
  - Also includes "anything that counts as 'fraud' and is done with wrongful intent"
  - Includes "deception or trickery generally"
- Court then refers to the Statute of 13 Eliz. (1571), and its durability
- "The degree to which this statute remains embedded in law related to fraud today clarifies that the common-law term "actual fraud" is broad enough to incorporate a fraudulent conveyance"

Husky, Continued

- Fraudulent conveyances, however, do not require a misrepresentation – fraudulent conveyances "are not an inducement-based fraud."
- "[F]raudulent conduct . . . [exists] in the acts of concealment and hindrance."
- Under fraudulent conveyance law, "both the debtor and the recipient of the conveyed assets were liable for fraud even though the recipient of a fraudulent conveyance of course made no representation, true or false to the debtor's creditor."

Husky, Continued

- Ritz conceded that "fraudulent conveyances are a form of 'actual fraud'" (!)
- Ritz tried to show that allowing fraudulent conveyances as fraud under § 523(a)(2) would result in overlapping exceptions and would impinge on § 727(a)(2), the fraud exception to discharge
  - Court not impressed
  - Court acknowledges duplication among nondischargeability counts, but also notes that no duplication swallows or makes redundant any of the other exceptions
  - Court makes distinctions between the blunderbuss of denial of discharge and the precise shot of nondischargeability

Husky, Continued

- Ritz then argues that to be exempt from discharge, the debt be for "credit . . . obtained by . . . actual fraud"
- Since the transfers to the affiliated companies were made after the $164,000 debt accumulated, the debt was not "obtained" by fraud
- Maybe so, says the Court – as to Chrysalis
- As to the recipient of the fraudulent transfer, however, it is a different story
- The recipient "can 'obtai[n]' assets 'by' his or her participation in the fraud
- "If the recipient later files for bankruptcy, any debts 'traceable to' the fraudulent conveyance . . . will be nondischargeable under § 523(a)(2)."

Husky, On Remand

- Fifth Circuit issued opinion on remand: *Husky Int'l Elecs. v. Ritz (In re Ritz)*, 2016 WL 4253552 (5th Cir., Aug. 10, 2016)
- Judge King sends the case back to the trial court for a determination as to whether Ritz was liable under Tex. Bus. Org. Code § 21.223(b), which the court characterized as Texas' "veil-piercing statute"
  - Does not address the "obtained by" argument
- "Ritz's liability to Husky under Texas law is a threshold question with respect to whether Ritz may be denied a discharge under § 523(a)(2)(A) because, if Ritz is not liable under Texas law, then he owes no debt to Husky"

Relevant Cases – From the Supremes

- *Field v. Mans*, 516 U.S. 59 (1995)
  - The level of creditor reliance on a fraudulent misrepresentation necessary to make the debt nondischargeable under §523(a)(2)(A) is **justifiable reliance**, not reasonable reliance.
- *Grogan v. Garner*, 498 U.S. 279 (1991)
  - The preponderance of the evidence standard, rather than clear and convincing evidence, applies to all exceptions from dischargeability of debts in Section 523(a), including nondischargeability for fraud.
- *Cohen v. De La Cruz*, 523 U.S. 213 (1998)
  - Allowing punitive damages to be nondischargeable on theory that the nondischargeable portion of the debt is not limited to the value of the "money, property, services, or … credit" obtained by the debtor through fraud.

Other Relevant Cases – Pre-*Husky*

- *Tummel & Carroll v. Quinlivan (In re Quinlivan),* 434 F.3d 314 (5th Cir. 2005)
  - Debt incurred as a result of fraud is not dischargeable even if the debtor did not know or had no reason to know that his agent was acting fraudulently.
- *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) (Posner, J.)
  - Debtor's receipt of fraudulently transferred property creates new debt upon receipt
  - Debt so arising "is obtained" through the fraud (actual or otherwise) that lead to the transfer
  - Amount of debt, however, is limited to the liability under fraudulent transfer law, so nondischargeable portion of debt is limited to the value of the property fraudulent transferred

Other Relevant Cases – Post-*Husky*

- *Husky Int'l Elecs. v. Ritz (In re Ritz),* 2016 WL 4253552 (5th Cir., Aug. 10, 2016) (Fifth Circuit on remand from Supreme Court)
  - Judge King sends the case back to the trial court for a determination as to whether Ritz was liable under Tex. Bus. Org. Code § 21.223(b), which the court characterized as Texas' "veil-piercing statute"
  - Does not address the "obtained by" argument
- *Kern v. Taylor (In re Taylor),* 551 B.R. 506 (Bankr. M.D. Ala. June 6, 2016).
  - Portion of complaint challenging dischargeability based on § 523(a)(2)(A) is dismissed due to failure of plaintiff to allege that debtor received a benefit from alleged wrongful conduct.
  - Rejects argument that *Husky* abrogated this requirement.

Hypothetical – Softbump

- Couple form Softbump to make soft playground chips
  - Each takes modest $50,000 annual salary
  - Business booming
- Softbump borrows $7 million from Equip to acquire equipment to manufacture chips
  - One spouse is unaware of the last $2M borrowed
- Couples' daughter (Kimmie) develops skin disease. Mother and daughter tour world seeking cure (and occasionally undertaking business meetings)
  - All trip and medical expenses charged to Softbump's credit card, issued by EZ Cred
- Softbump's fortunes fade, as rumors connect skin disease to Softbump.
  - Husband takes on new unsecured debt for Softbump
  - Husband lies to old secured creditor about pending class action claiming chips cause disease in order to obtain forbearance agreement
  - Wife signs new loan and forbearance agreement without reading
  - Husband and Wife increase salaries to $350,000 per year each

Hypothetical – Softbump's Woes Continued

- One year later
  - Kimmies's disease, and the disease complained about in the class action, is found to stem from Softbump's products
  - Softbump shuts down
  - Secured lender forecloses on everything and still has deficiency
- Couple held to be alter egos of Softbump in state court litigation
- Couple files chapter 7 case
- § 523(a)(2) actions filed by:
  - Secured lender (Equip)
  - Credit card company (EZ Cred)
  - New unsecured creditor (Sharkie); and
  - Class action plaintiffs in suit claiming products liability
- Results?

Husky, questions

- The Fifth Circuit holds that Ritz's liability arises under the Texas veil-piercing statute, and then looks to whether fraudulent transfer law would characterize any liability found as "actual fraud."
  - Wouldn't Ritz also be liable on a transferee theory under the UFTA?
  - Or if he was not liable for Chrysalis' debts, if one of Chrysalis' affiliate-transferees was subject to veil piercing?
- Does the Court's analysis make Ritz both the transferor (as being collapsed with Chrysalis) and the transferee?
  - That's what note 3 says . . . .
- Could the SEC or the IRS challenge *a corporation's or LLC's* chapter 11 plan under 1141(d)(6), contending that a fraudulent transfer was a debt "of a kind" specified in 523(a)(2), and thus all their unsecured tax debts or fines under the Securities Acts were "obtained by" fraud and thus non-dischargeable?
- Has the Supreme Court surrendered the issue of what constitutes fraud to the states, such that the states could, through legislation, effectively prevent a fresh start for certain types of debt?

2016 ABI WINTER LEADERSHIP CONFERENCE
HYPOTHETICAL FOR "HUSKY" DISCUSSION

Robbie and Kristie Jones formed Softbump, a tire recycling company, that manufactured clean, soft "chips" to be used in playgrounds and parks. Robbie and Kristie drew salaries of $50,000 each, annually. Softbump's product became the "go-to" product for schoolyards and public parks, and profits began to soar. Robbie and Kristie purchased state-of-the-art equipment from Equip for $5 million for their gleaming new factory. The acquisition was financed by Equip under a five-year term loan, signed by Robbie and Kristie on behalf of the company, that required monthly principal and interest payments. While Kristie was concerned that Softbump may be incurring too much debt, Robbie ignored her concerns and, without Kristie's knowledge, purchased some optional equipment from Equip for an additional $2 million, pursuant to a second term loan, signed only by Robbie on behalf of Softbump.

While Softbump was thriving, Robbie and Kristie's 35-year old spoiled daughter, Kimmie, contracted a rare and unsightly skin condition that could not be concealed, even by the tons of make-up Kimmie wore. Kristie stopped going to work and began travelling around the world with Kimmie, looking for a cure for her condition. Occasionally during these trips, Kristie would attend a Softbump business meeting. Along the way, Kristie spent hundreds of thousands of dollars on gifts and spa treatments for Kimmie. Kristie charged all of the expenses for these trips, including Kimmie's gifts and spa treatments, to Softbump's credit card, issued by EZCred. All of EZCred's bills were paid by Softbump.

Stories began circulating that Softbump's product had caused Kimmie's skin condition as well as similar skin conditions for a number of other children, and Softbump's sales slowed. Kristie hardly ever came into work, and Robbie did not want to tell her how poorly Softbump was doing. Robbie obtained an unsecured loan for the company at a ridiculously high interest rate from Sharkie, and entered into a forbearance agreement with Equip by disavowing the rumors about Softbump's product and failing to disclose the putative class action lawsuit that had been commenced against Softbump. The loan documentation and forbearance agreement were signed by Robbie and Kristie for the company, although Kristie claims she was unaware of the disclosures/non-disclosures about the rumors and the lawsuit. Robbie and Kristie then raised their salaries to $350,000 each so that they could continue to pay for Kimmie's treatments, travel and gifts, while they tried to dispel the rumor about Softbump's product.

One year later, it was determined that Softbump's product caused the skin condition, which led to plummeting sales and the eventual inability of Softbump to continue operations. Softbump shut down operations and its assets were liquidated by Equip for net proceeds far less than the balance of the debt owed to Equip, with no monies for other creditors. In state court litigation, the court held Robbie and Kristie to be alter egos of Softbump under the applicable

law of the state where Softbump was located. Shortly thereafter, Robbie and Kristie filed a joint petition for relief under Chapter 7 of the Bankruptcy Code.

Complaints objecting to discharge under 11 U.S.C. Section 523(a)(2)(A) were filed against both Robbie and Kristie, by Equip, EZCred, Sharkie, and the putative class action plaintiffs complaining that they were suffering from the skin condition caused by Softbump. Robbie and Kristie, recognizing that their situation requires a much more capable and experienced lawyer than the one they engaged to file their Chapter 7 papers has engaged you and your firm to advise them as to how to assess the risks presented by the nondischargeability complaints and what outcomes to expect under the current state of the law.

ABI WINTER LEADERSHIP CONFERENCE

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INSIGHTS AND ISSUES FROM PRE-HUSKY AND POST-HUSKY CASE LAW ABOUT THE POSSIBLE APPLICATION OF HUSKY TO FUTURE NONDISCHARGEABILITY CASES

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I. Introduction

For many, the Supreme Court's interpretation of Section 523(a)(2)(A) of the Bankruptcy Code in Husky International Electronics, Inc. v. Ritz, 136 S. Ct. 1581 (2016), was unexpected. An analysis of the Husky opinion is provided in the PowerPoint materials accompanying this article and will be the focus of the panel's presentation at the conference program.

The Supreme Court's broad interpretation of the term "actual fraud" was not surprising, but the application of the statute to a fraudulent transfer where the fraud did not occur at the inception of the creditor's initial claim certainly calls for a more careful review of prior case law.[1] With this in mind, we will review some of the leading pre-Husky nondischargeability cases, through the lens of the Husky opinion, to develop a deeper understanding of the jurisprudence that has developed under Section 523(a)(2)(A) and how Husky may be applied in future cases. We also will review selected post-Husky cases that offer useful examples of what to expect as courts have begun to evaluate fraudulent transfer claims under Section 523(a)(2).

[1] It should be noted that Husky does not purport to address the question of whether the creditor's claim in Husky met the requirement that "money, property, services, or an extension, renewal, or refinancing of credit" was "obtained by" fraud. However, the majority held that while the transferor of a fraudulent conveyance does not obtain property by the fraud, a transferee may meet this requirement. 136 S.Ct. at 1589. In contrast to the majority, Justice Thomas concluded that a creditor's claim based on a fraudulent transfer does not meet the "obtained by" requirement of Section 523(a)(2). Id. at 1590-94.

II. Selected Pre-Husky Cases

A. Field v. Mans, 116 S. Ct. 437 (1995):

1. Held: The level of creditor reliance on a fraudulent misrepresentation necessary to make the debt nondischargeable under §523(a)(2)(A) is *justifiable* reliance, not *reasonable* reliance.

2. The key facts: Corporation controlled by debtor purchased real property, the consideration for which included a promissory note secured by a second mortgage on the property. The mortgage required the creditor's consent to any conveyance of the real property, without which the note would become automatically due. Four months after closing, the purchaser corporation conveyed the property without the creditor's knowledge or consent. The next day the debtor wrote to the creditor and asked for waiver of the due-on-sale clause, without disclosing the prior conveyance. The creditor offered to waive the clause for $ 10,500, but the debtor never accepted or paid that amount. Later, the debtor filed bankruptcy and the creditor filed a complaint to determine its claim to be nondischargeable under §523(a)(2)(A). The bankruptcy court found that the debtor's letters to the creditor were false representations but held that the creditor did not reasonably rely on them, since he could have learned of the conveyance by checking the state of title to the property. The issue before the Supreme Court was whether the creditor was required to show reasonable reliance or the lesser standard of justifiable reliance. As noted above, the Supreme Court held that the lesser standard applied, reversing the lower courts and remanding the case for further proceedings consistent with its opinion.

3. Open question on remand: Whether the creditor's claim met the "obtained by" requirement of §523(a)(2)(A). See 116 S. Ct. at 448 (Justice Ginsburg's concurring opinion).

4. Subsequent Case History of Interest:

a. Unfortunately for the creditor, proceedings on remand proved to be quite lengthy. First, the bankruptcy court determined that the only issue to be decided on remand was whether the creditor demonstrated justifiable reliance on the debtor's misrepresentation, and held he did, and that the debt therefore was not dischargeable, without any discussion of the "obtained by" requirement. Field v. Mans, 200 B.R. 293 (Bankr. D.N.H. 1996).

b. The debtor then filed a motion to alter or amend on the grounds that there was no finding that there was a debt or extension of credit "obtained by" the fraud, and that the creditor's forbearance from accelerating the note did not constitute an extension of credit within the meaning of §523(a)(2)(A). The bankruptcy court determined that its previous rulings included a finding that there was an extension of credit, and the court therefore denied the motion on the basis of "law of the case" doctrine. 203 B.R. 355 (Bankr. D.N.H. 1996). The court also noted, in *dictum*, that had that doctrine not applied, it would have determined that a creditor deceived into forbearing does meet the requirements of §523(a)(2)(A).

c. On appeal, the First Circuit Bankruptcy Appellate Panel rejected the conclusion based on "law of the case" doctrine and held that the debtor's fraud was not an extension of credit within the meaning of §523(a)(2)(A). Recognizing a split in the case law, the

court held that the term "extension … of credit" in the statute did not encompass a failure to accelerate the debt, and noted that the record did not establish that the creditor would have accelerated the debt had it known of the debtor's concealed transfer.

d. The creditor appealed to the First Circuit which reversed on the extension of credit issue. According to the court: "fraudulent concealment and frustration of the Fields' acceleration right was tantamount to an 'extension', i.e. continuation, of the existing credit." In other words, the debtor's fraud tended to perpetuate, hence extend, the credit. Accordingly, the First Circuit decision stands for the proposition that a failure to accelerate or call a loan as a result of a fraudulent misrepresentation constitutes an extension of credit and therefore meets the causal requirement that the debt be "obtained by" fraud under § 523(a)(2)(A).

B. **Grogan v. Garner**, 498 U.S. 279 (1991):

1. **Held:** The *preponderance of the evidence* standard, rather than *clear and convincing* evidence, applies to all exceptions from dischargeability of debts in Section 523(a), including nondischargeability for fraud.

2. **The key facts:** Creditor obtained a judgment in state court against the debtor for fraud in connection with the sale of corporate securities, and obtained an award of actual and punitive damages. The court instructed the jury that the standard of proof was preponderance of the evidence. After the debtor filed a Chapter 7 petition, the creditor brought an adversary proceeding against the debtor to determine the judgment claim to be nondischargeable. The bankruptcy court held that the doctrine of collateral estoppel required holding the debt to be not dischargeable. The debtor appealed, arguing that collateral estoppel should not apply because a determination of nondischargeability under § 523(a)(2)(A) required proof by clear and convincing evidence. The district court rejected that argument but the Eighth Circuit agreed with the creditor and reversed. The Supreme Court reversed the Eighth Circuit's decision and affirmed the decision of the bankruptcy court.

3. **Significance for Husky issues:**

a. The debtor limited his argument to the standard of proof and apparently raised no other issue. In footnote 2, the Court noted:

> "We therefore do not consider the question whether § 523(a)(2)(A) excepts from discharge that part of a judgment in excess of the actual value of money or property received by a debtor by virtue of fraud. …. Arguably, fraud judgments in cases in which the defendant did not obtain money, property, or services from the plaintiffs and those judgments that include punitive damages awards are more appropriately governed by § 523(a)(6)(excepting from discharge debts 'for willful and malicious injury by the debtor to another entity or to the property of another entity'). *In re Rubin*, 875 F.2d at 758 n. 1."

b. Footnote 2 would seem to support the idea that the determination of nondischargeability of a debt under § 523(a)(2)(A) might be limited to the value of the money or property received by the debtor as a result of the fraud. However, any such suggestion is no longer sustainable as a result of the Supreme Court's decision in Cohen v. De La Cruz, 523 U.S. 213 (1998), discussed next, holding that treble damages awarded to the creditor based on the debtor's fraud are not dischargeable under § 523(a)(2)(A).

C. Cohen v. De La Cruz, 523 U.S. 213 (1998):

1. Held: Section 523(a)(2)(A) bars the discharge of treble damages awarded on account of the debtor's fraudulent acquisition of "money, property, services, or … credit", because the nondischargeable portion of the debt is not limited to the actual value of the "money, property, services, or … credit" obtained by the debtor through fraud.

2. The key facts: Debtor owned residential properties in Hoboken, New Jersey, one of which was subject to rent control laws. Debtor was found to have charged rents above legal limits and ordered to refund the excess rents but failed to comply with the order. After the debtor filed a Chapter 7 petition, the tenants filed a complaint to determine their claims to be nondischargeable under § 523(a)(2)(A) for actual fraud, and also sought treble damages and attorneys' fees and costs under the New Jersey Consumer Fraud Act. After trial, the bankruptcy court found for the creditors and awarded treble damages plus attorneys' fees and costs. The District Court and Third Circuit affirmed, and so did the Supreme Court.

3. Significance for Husky issues: The Supreme Court applied a straightforward reading of § 523(a)(2)(A), which provides for the nondischargeability of "any debt" for "money, property, services, or … credit, to the extent obtained by" fraud. The Court found the plain meaning of these words to be unambiguous -- if the debt arose from fraud, the nondischargeability of the claim is not limited to the value of the "money, property, services, or … credit" so obtained. 523 U.S. at 218-21. Query whether the same plain meaning approach to statutory construction would lead the Supreme Court to hold that the fraud need not be that of the debtor to be nondischargeable, if the debtor, under state law, is jointly liable with the fraud doer. Under a prior bankruptcy act, the Supreme Court held this to be the law. See Strang v. Bradner, discussed below. This also is the view of the Fifth Circuit, as confirmed in Tummel & Carroll v. Quinlivan (In re Quinlivan), 434 F.3d 314 (5th Cir. 2005), discussed below. Such an approach, arguably, is inconsistent with the case law referring to the right of an honest debtor to a fresh start and limiting nondischargeability determinations to acts of a dishonest debtor or misconduct of the debtor involving moral turpitude or intentional wrong. See, e.g., Bullock v. Bankchampaign, N.A., 133 S. Ct. 1754 (2013), discussed next.

D. Bullock v. Bankchampaign, N.A., 133 S. Ct. 1754 (2013):

1. Held: Section 523(a)(4), which excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny", requires a "culpable state of mind requirement akin to that which accompanies application of the other terms in the same statutory phrase". That "culpable state of mind" requires "knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior." 133 S. Ct. at 1757.

2. The key facts: The debtor, a nonprofessional, was appointed by his father to be the trustee of a trust for the benefit of the father's five children. The sole asset of the trust was a life insurance policy on the father. The trust agreement permitted the trustee to borrow funds from the insurer against the policy's value. On three occasions, the debtor borrowed funds from the trust, once at his father's request to repay the debtor's mother for a loan to the father's business, and two other times when the funds were used to buy a mill and real property, respectively, for the debtor and his mother. All borrowed funds were repaid with interest. The debtor's brothers sued him in state court for breach of fiduciary duty, and although the state court found that the debtor had no "malicious motive" in borrowing funds from the trust, it held him liable for self-dealing. The state court imposed constructive trusts on the debtor's interests in the mill and the trust to secure payment of the judgment. When the debtor filed for bankruptcy relief, the state court-appointed substitute trustee challenged the dischargeability of the claims against the debtor under § 523(a)(4). The bankruptcy court granted summary judgment for the trustee and the District Court and Court of Appeals affirmed, holding the debt to be nondischargeable. The Supreme Court vacated and remanded, holding that "the conduct at issue does not involve bad faith, moral turpitude, or other immoral conduct," the terms used in § 523(a), and these terms require an "intentional wrong", which includes "reckless conduct of the kind that the criminal law often treats as the equivalent." 133 S. Ct. at 1759.

3. Significance for Husky issues: Although this is a § 523(a)(4) case, it is a recent example of the Supreme Court adhering to the long-standing principle that "'exceptions to discharge 'should be confined to those plainly expressed.'" Id. at 1760.

E. Neal v. Clark, 95 U.S. 704 (1877):

1. Held: Determination of the meaning of the term "fraud" in the Bankruptcy Act of 1867.

2. The key facts: The creditor, a surety company, challenged the bankruptcy discharge of the debtor, who had purchased bonds from an executor of the estate in a transaction subsequently held to have been a waste of estate assets and following which the executor failed to account for the amount of the bonds sold to the debtor. The lower state court determined the debtor had committed "constructive fraud" and that he was jointly liable with the executor. The Supreme Court determined that because the debtor had not committed actual fraud, and had purchased the bonds in good faith with no knowledge of the executor's wrongdoing, the creditor's claim was dischargeable. However, under the language of the 1867 Bankruptcy Act, to be nondischargeable the debt had to be "created by the fraud or embezzlement of the bankrupt". 95 U.S. at 709 (emphasis added).

3. Significance for Husky Issues:

a. It is possible to view Neal v. Clark as not relevant to the Husky debate because of the language of the 1867 statute specifically referring to the "fraud … of the bankrupt". However, this case, as well as the 1867 statute, demonstrate a focus on the wrongfulness of the conduct of the debtor. This might serve as a basis to argue that the same focus should be applied under Section 523(a)(2)(A), and that a debtor who receives a fraudulent transfer with no knowledge of any wrongfulness should be discharged from the debt. However,

the Supreme Court case of Strang v. Bradner, discussed below, contradicts that argument. The more recent case of In re Quinlivan, 434 F.3d 314 (5th Cir. 2005), discussed below, also adopts the view that even an innocent debtor may lose a nondischargeability case based on the fraud of an agent of the debtor.

F. Strang v. Bradner, 114 U.S. 555 (1885):

1. Held: Debt incurred as a result of the fraud of the debtor's business partner was held not to be dischargeable, even though the debtor had no involvement or knowledge of the fraud, where the fraudulent conduct resulted in the debtor's business receiving "the fruits of the fraudulent conduct" of the partner. 114 U.S. at 561.

2. The key facts: The creditors purchased wool from a partnership consisting of the debtor and the debtor's partner, who sold the creditors wool on commission. The creditors issued notes which the debtor and his partner used to obtain funds for their business. In February 1885, the debtor's business requested four notes which the creditors issued. In March, the debtor's partner, acting for the business, falsely represented to the creditors that they had not been able to use the February notes and requested four more notes, which the creditors provided. In fact, the debtor's business had used the February notes and was insolvent. The evidence showed that the debtor was not aware of his partner's false representations, but that the proceeds of the March notes were received by the debtor's business.

3. Significance for Husky issues: Like Neal v. Clark, Strang was decided when the governing bankruptcy statute provided for an exception to the bankruptcy discharge for any "debt created by the fraud or embezzlement *of the bankrupt*". A plain reading of this statute would suggest that if the debtor committed no fraud, this exception to dischargeability should not apply. Despite this statutory language and the Supreme Court's opinion in Neal v. Clark, Strang held nondischargeable the debt owed by an innocent debtor who was liable under state law imputing liability to the debtor for the fraud of the debtor's partner, where the benefits of the fraudulent conduct was received by the partnership.

G. Tummel & Carroll v. Quinlivan (In re Quinlivan), 434 F.3d 314 (5th Cir. 2005):

1. Held: Debt incurred as a result of fraud is not dischargeable even if the debtor did not know or had no reason to know that his agent was acting fraudulently.

2. The key facts: President of company induced law firm, through misrepresentations, to file suit on behalf of two companies and the vice president against a bank on a contingent-fee basis. The vice president signed the engagement letter individually and on behalf of the companies. In the litigation, bad facts concealed from the law firm were revealed and the plaintiffs dropped the suit. Under the engagement letter the creditor law firm was entitled to be paid its fees on an hourly basis upon such circumstances. The clients failed to pay and the vice president filed for bankruptcy relief under Chapter 7. The law firm filed an adversary proceeding to have its claim determined to be nondischargeable under § 523(a)(2)(A). The bankruptcy court held that because the debtor had made no fraudulent representation to the creditor the debt was dischargeable. On appeal, the creditor argued that the debtor should be

held responsible for the president' misrepresentations on an agency theory. The district court rejected that argument due to the absence of any formal agency agreement. On appeal, the Fifth Circuit reversed and remanded, holding that even if the partner were innocent of wrongdoing and had no knowledge or reason to know of the fraud, the debt would not be dischargeable under § 523(a)(2)(A) if the president was found to be the debtor's agent.

3. Significance for Husky issues: This is an example of a Circuit Court recognizing that the debtor facing the § 523(a)(2)(A) complaint may have a debt determined to be nondischargeable even if the debtor did nothing dishonest, based on the fraud of another who is determined to be a partner or agent. The Fifth Circuit previously adopted this view in Deodati v. M.M. Winkler & Associates (In re M.M. Winkler & Associates), 239 F.3d 746 (5th Cir. 2001). According to Winkler: "§ 523(a)(2)(A) prevents an innocent debtor from discharging liability for the fraud of his partners, regardless whether he receives a monetary benefit." 239 F.3d at 751. The opinion recognizes that there is a split among the Circuit Courts as to whether § 523(a)(2)(A) requires that the debtor receive benefits from the alleged fraud. Id. at 750-51.

H. McClellan v. Cantrell, 217 F.3d 890 (7th Cir. 2000)(Posner, C.J.)

1. Held: Debt incurred by a transferee of a fraudulent transfer, who colluded with the transferor to defraud the transferor's creditor, is not dischargeable under § 523(a)(2)(A). The "obtained by" requirement of the statute is met, even though the creditor's original claim against the transferor was based on a simple commercial transaction not involving fraud, because the transferee's liability to the creditor arose as a result of the transferee obtaining property by actual fraud.

2. The key facts: Creditor sold ice-making machinery to the debtor's brother for $ 200,000 payable in installments, and retained a security interest in the machinery which was never perfected. The brother owed a balance of $ 100,000 when he defaulted. The creditor then filed suit in state court, and requested an injunction against the transfer of the equipment. Despite having knowledge of the pending suit, the brother transferred the machinery to his sister for $10; the sister knew about the suit and knew her brother made the transfer to thwart the creditor's collection efforts. The sister-debtor then sold the machinery for $160,000 and did not divulge what happened to the sale proceeds. The creditor added the sister as a defendant to the suit, and she later filed a Chapter 7 petition. The creditor filed a nondischargeability complaint but the bankruptcy court dismissed the complaint on the ground that the debt was dischargeable, and the district court affirmed. According to the district court, the Supreme Court held in Field v. Mans that § 523(a)(2)(A) requires a showing of "material misrepresentation and reliance on [a] statement" of the debtor". 217 F.3d at 892. The Seventh Circuit reversed, holding -- as the Supreme Court did in Husky-- that "actual fraud" within the meaning of § 523(a)(2)(A) is broader than misrepresentation. Id. at 893.

3. Significance for Husky issues: Only time will tell how the courts apply Husky. However, the writers believe that Chief Judge Posner's interpretation of the "obtained by" requirement of § 523(a)(2)(A) is the correct and proper way to think about § 523(a)(2)(A)

after Husky, especially with respect to claims arising from fraudulent transfers.[2] First, as a matter of policy, Judge Posner, like the Supreme Court in Husky, considered it unthinkable that a person could collude with another to commit an actual fraudulent transfer to defeat the rights of a creditor and get away with it by obtaining a discharge of the debt. Any other result, he explained, would turn "bankruptcy into an engine for fraud."[3] Id. Second, it is significant that the McClellan opinion only applies to a debtor transferee who knows that the transfer was a fraud on creditors, not an innocent transferee. As explained in the opinion, while the fraud occurred well after the debtor's brother originally incurred the debt to the creditor, the debtor-transferee incurred her separate debt to the creditor when she colluded with her brother in receiving the fraudulent transfer. Her debt was based on her own actual fraud against the creditor. The opinion gives an example: if the creditor was owed $100,000 and the fraudulent transfer involved property worth only $10,000, the claim against the debtor-transferee would be nondischargeable only to the extent of $10,000, the amount of the debtor's liability for fraud. Id. at 895. Judge Posner thus reconciled the "obtained by" requirement with the requirement that the debt be for "money, property, services … or credit" in the context of a fraudulent transfer situation where the creditor was not defrauded at the inception of the creditor's original claim, by concluding that a creditor need not be the victim of the fraud at the time of the transfer, so long as the debtor obtains money, property or services as a result of a fraud. Id.

III. Selected Post-Husky Cases

A. Introduction: As of October 19, 2016, Husky has been cited in 33 cases. The cases cited below are worth discussing as examples of how courts have interpreted Husky, especially with respect to the courts' interpretation of how to apply the "obtained by" requirement in light of Husky.

B. Selected Cases:

1. Kern v. Taylor (In re Taylor), 551 B.R. 506 (Bankr. M.D. Ala. June 6, 2016).

a. Held: Portion of complaint challenging dischargeability based on § 523(a)(2)(A) is dismissed due to failure of the complaint to allege that the debtor received a benefit from alleged wrongful conduct, following pre-Husky 11th Circuit precedent (HSSM #7 Ltd. P'ship v. Bilzerian (In re Bilzerian), 100 F.3d 886, 890 (11th Cir. 1996)). The court found unpersuasive the creditor's argument that Husky abrogated this requirement.

b. The key facts: Plaintiffs were investors in two real estate projects the debtor managed. After the projects failed, the investors sued the debtor in state court for

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[2] It is noteworthy that the Supreme Court in Husky cited to McClellan as support for the conclusion that while the transferor in a fraudulent transfer does not "obtain" debts through such a transfer, "the recipient of the transfer—who, with the requisite intent, also commits fraud—can 'obtai[n]" assets 'by' his or her participation in the fraud." 136 S. Ct. at 1589.

[3] The concurring opinion in McClellan has an easy way to avoid allowing a debtor to get away with fraud without a strained reading of § 523(a)(2)(A), by holding the debt nondischargeable under § 523(a)(6). Id. at 896.

fraud, breach of contract and breach of fiduciary duties. After the debtor filed a Chapter 7 petition, the investors filed a complaint to determine nondischargeability under §§ 523(a)(2)(A), (a)(2)(B), and (a)(4). In dismissing the creditors' claims based on § 523(a)(2)(A), the court cited Field v. Mans, and noted that a debt is nondischargeable when it "follows a transfer or extension induced by a materially false and intentionally deceptive written statement of financial condition upon which the creditor reasonably relied." (Internal quotations omitted). Although there were arguments as to whether the creditors relied on the alleged false representations, the court dismissed the count based on the absence of any allegations that the debtor benefited from the false representation. The creditors obtained denial of the rest of the motion to dismiss filed by the debtor, because the court determined that the creditors had sufficiently alleged claims under the other provisions of § 523(a).

c. Significance for Husky issues: The opinion considers Husky and Cohen v. De La Cruz, and other cases and concludes that for § 523(a)(2)(A) to apply, the debtor must receive a benefit from the alleged fraud in order for the debt to be nondischargeable under this section. 551 B.R. at 517-18. The Taylor court also makes the seemingly inconsistent observation that the Supreme Court, in Husky, suggested that the "obtained by" requirement need not be limited to the debtor: "when property is obtained by those in league with the debtor as a result of the debtor's fraud, the requirement is met for a finding of non-dischargeability under § 523(a)(2)(A)." 551 B.R. at 517-18 (citing to 136 S. Ct. at 1589 of Husky). To the extent that Taylor intended to suggest that the portion of the Husky opinion cited supports the conclusion that the debtor need not receive a benefit – which directly contradicts the Taylor court's holding that the debtor must receive a benefit-- Taylor is mistaken.

2. Hatfield v. Thompson (In re Thompson), 2016 WL 4413906 (B.A.P. 10th Cir. Aug. 19, 2016).

a. Held: A creditor's claim against the debtor, a principal of a nursing home, which was based on a state law veil piercing theory, met the requirements for stating a nondischargeability claim under § 523(a)(2)(A) even though the creditor's claim against the nursing home was based on negligence and not fraud. There is no requirement that the debtor "obtain the debt by actual fraud or that the debt is for something the debtor obtained by actual fraud." Id. at *13.

b. The key facts: The debtor owned four companies which leased and operated nursing homes. The creditor's wife was a resident at one of the nursing homes, and died while there. The creditor filed a state court action against the company owning the nursing home and the debtor based on alleged sub-standard care provided to the creditor's wife, and requested actual and punitive damages. The debtor filed a Chapter 7 petition the morning of the trial, and the company failed to appear at trial, resulting in a default judgment against the company. Based on damages evidence presented, the state court awarded $750,000 in actual damages and $250,000 in punitive damages against the company. The creditor filed a nondischargeability complaint against the debtor, under a§ 523(a)(2)(A), alleging that he was personally liable for the judgment under a corporate veil piercing theory under the state law allowing piercing of the corporate veil "under the legal doctrine of fraud." The bankruptcy court granted summary judgment in favor of the debtor, holding that the debt at issue was not the type

that fell within § 523(a)(2)(A) and that the creditor could not satisfy the elements for fraud under state law. The creditor appealed and the 10th Circuit Bankruptcy Appellate Panel reversed.

The court noted that while the creditor's claim against the nursing home company was based on negligence, his claim against the debtor was based on a fraud theory. The court further explained that a nondischargeability action requires a two-part analysis: (1) first, the bankruptcy court must determine the validity of the debt; and (2) second, the court must determine whether the debt is dischargeable under § 523. Id. at *4. To prove the latter, the creditor must show (i) that the debtor committed actual fraud, (ii) that the debtor obtained money, property, services, or credit by the actual fraud, and (iii) the debt arises from the actual fraud. Id. at *6. Citing Husky, the court stated that "there is no requirement that a creditor rely on the actual fraud or part with assets or receive credit at the inception of, or concurrently with, the actual fraud." Id. In further reliance on Husky, the court noted that there also is no requirement "that the debtor's actual fraud induced the creditor to part with property or extend credit." Id.

The creditor alleged, in support of his fraud claim, that the debtor owned and controlled the nursing home, made false representations to the state licensing authority to get a license to operate, the debtor drained the nursing home's assets and diverted them to other businesses owned by the debtor or his brother, and that the creditor's wife's death was a consequence of the debtor's actions. The appellate court found these allegations sufficient to establish actual fraud under § 523(a)(2).

The most interesting part of the opinion is its discussion of the "obtained by" requirement of § 523(a)(2). The court first noted that "there is no requirement that the debt be for something the debtor obtains from the creditor." Id. at *7. The court stated that there is no requirement "that the debtor obtain the debt by actual fraud or that the debt is for something the debtor obtained by actual fraud." Id. at *8 (while noting a circuit split as to whether a debtor must personally receive money, property, services, or other credit). In Thompson, the debt the creditor sought to except from discharge was based on the theory that the debtor was liable under a fraud-based corporate veil piercing claim, which was similar to the claim at issue in Husky. Because of factual issues, the appellate court determined that the summary judgment below in favor of the debtor should be reversed and the case was remanded to the bankruptcy court for further proceedings.

c. Significance for Husky issues: This is a good example of the impact of Husky on nondischargeability litigation. Although the creditor's claim was a tort claim, and the debtor was not the tortfeasor, the creditor had an independent fraud theory for holding the debtor liable for the claim, and the court held that the allegations were sufficient to meet the "obtained by" requirements of § 523(a)(2).

3. Scarbrough v. Purser (In re Scarbrough), 2016 WL 4575566 (5th Cir. Sept. 1, 2016).

a. Held: A creditor is not required to show that the debtor received a direct benefit to meet the requirements of excepting the debt from discharge under § 523(a)(2).

b. The key facts: The debtor was a lawyer representing a client in certain litigation, in connection with which he committed extremely bad and malicious acts, including filing false police reports, intentionally concealing evidence from the plaintiffs, and uploading on YouTube defamatory allegations. The state court held the debtor liable for fraud, civil conspiracy and defamation, following which the debtor filed a Chapter 7 petition. The fraud claim was based on the debtor's concealment of evidence that was very harmful to the debtor's client. The creditors filed a nondischargeability complaint seeking to except their claims from discharge under §§ 523(a)(2), (4), and (6). The bankruptcy court granted the creditors the requested relief, and the district court and Fifth Circuit affirmed.

c. Significance for Husky issues: The Fifth Circuit's discussion of the § 523(a)(2) issue on appeal is very brief. The only point relevant to Husky issues is the debtor's argument that the debt did not meet the requirements of the statute because the jury was not required to find that anyone received a benefit from the debtor's misconduct. The Fifth Circuit rejecting the debtor's argument, stating: "A creditor is not required to show that the debtor received a direct benefit as a prerequisite for a determination that a fraud debt is nondischargeable." Id. at *4 (citation omitted). Although the debtor's conduct was extremely bad, and included actual fraud—the debtor certainly was not the honest debtor for which a bankruptcy discharge is intended -- it is difficult to discern from the Fifth Circuit's opinion how the facts met the "obtained by" requirement of § 523(a)(2).