No. _____

In The
Supreme Court of the United States

KATE MARIE BARTENWERFER,

Petitioner,

v.

KIERAN BUCKLEY,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

IAIN A. MACDONALD
Counsel of Record
RENO F.R. FERNANDEZ III
MACDONALD FERNANDEZ LLP
221 Sansome Street
San Francisco, CA 94104
(415) 362-0449
iain@macfern.com

Counsel for Petitioner

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

May an individual be subject to liability for the fraud of another that is barred from discharge in bankruptcy under 11 U.S.C. (the "Bankruptcy Code") § 523(a)(2)(A), by imputation, without any act, omission, intent or knowledge of her own?

Circuit courts are irreconcilably split on this issue.

PARTIES TO THE PROCEEDINGS

Petitioner Kate Marie Bartenwerfer was a defendant and debtor in the bankruptcy court proceedings, was an appellant and cross-appellee in the proceedings of the bankruptcy appellate panel and was an appellee and cross-appellant in the proceedings before the Ninth Circuit.

Respondent Kieran Buckley was the plaintiff in the bankruptcy court proceedings, was the appellee and cross-appellant in the proceedings of the bankruptcy appellate panel and was the appellant and cross-appellee in the court of appeals proceedings.

David William Bartenwerfer was a defendant and debtor in the bankruptcy court proceedings, was an appellant and cross-appellee in the proceedings of the bankruptcy appellate panel and was an appellee and cross-appellant in the court of appeals proceedings. Mr. Bartenwerfer is not a party to this petition.

RELATED PROCEEDINGS

In re Bartenwerfer, No. 13-30827, U.S. Bankruptcy Court for the Northern District of California. Discharge entered December 15, 2014.

Buckley v. Bartenwerfer (In re Bartenwerfer), Adv. Proc. No. 13-03185, U.S. Bankruptcy Court for the Northern District of California. Judgment entered January 7, 2019.

RELATED PROCEEDINGS—Continued

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 16-1277, Bankruptcy Appellate Panel for the Ninth Circuit. Judgment entered December 22, 2017.

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 16-1299, Bankruptcy Appellate Panel for the Ninth Circuit. Judgment entered December 22, 2017.

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 18-60001, U.S. Court of Appeals for the Ninth Circuit. Dismissed March 28, 2018.

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 18-60007, U.S. Court of Appeals for the Ninth Circuit. Dismissed March 29, 2018.

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 19-1016, Bankruptcy Appellate Panel for the Ninth Circuit. Judgment entered April 23, 2020.

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 19-1025, Bankruptcy Appellate Panel for the Ninth Circuit. Judgment entered April 23, 2020.

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 19-1178, Bankruptcy Appellate Panel for the Ninth Circuit. Judgment entered April 23, 2020.

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 20-60020, U.S. Court of Appeals for the Ninth Circuit. Judgment entered August 12, 2021.

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 20-60021, U.S. Court of Appeals for the Ninth Circuit. Judgment entered August 12, 2021.

RELATED PROCEEDINGS—Continued

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 20-60022, U.S. Court of Appeals for the Ninth Circuit. Dismissed October 29, 2020.

Buckley v. Bartenwerfer (In re Bartenwerfer), No. 20-60023, U.S. Court of Appeals for the Ninth Circuit. Judgment entered August 12, 2021.

Bartenwerfer v. Buckley (In re Bartenwerfer), No. 20-60024, U.S. Court of Appeals for the Ninth Circuit. Judgment entered August 12, 2021.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

CONSTITUTIONAL PROVISIONS

STATUTES & RULES

TABLE OF AUTHORITIES—Continued

PETITION FOR A WRIT OF CERTIORARI

Kate Marie Bartenwerfer respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The memorandum of the Ninth Circuit (Petition Appendix ("Pet. App."), 1a-6a) is at 860 Fed. Appx. 544 and is not published.

The bankruptcy appellate panel's memorandum (Pet. App., 7a-30a) is at 2017 WL 6553392 and is not published.

The bankruptcy court's memorandum decision (Pet. App., 35a-59a) is published at 596 B.R. 675.

JURISDICTION

The Ninth Circuit entered its judgment in the form of its memorandum entered on August 12, 2021. (Pet. App., 1a-6a). The court of appeals' order denying a timely petition for rehearing *en banc* was entered on September 24, 2021. (Pet. App., 60a). This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Bankruptcy Code § 727(a) & (b).

(a) The court shall grant the debtor a discharge. . . .

(b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter. . . .

2. Bankruptcy Code § 523(a)(2)(A).

(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt . . .

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud. . . . 11 U.S.C. § 523(a)(2)(A) (2010).

3. U.S. Constitution, art. I, § 8, cl. 4.

The Congress shall have Power . . . To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States. . . . U.S. Const. art. I, § 8, cl. 4.

STATEMENT OF THE CASE

1. Introduction.

In the decision below, the Ninth Circuit ruled that an individual is subject to a nondischargeable liability for the fraud of another by imputation without any act, omission, intent or knowledge of the debtor's own. The decision applies a *per se* rule to Bankruptcy Code § 523(a)(2)(A) that admits of no exception for an innocent debtor who, consequently, must labor under a nondischargeable judgment indefinitely, without possibility of relief, for conduct over which she had no control or even knowledge.

The decision deepens an intractable split of authorities among the circuit courts that can be resolved only with this Court's intervention. Specifically, one camp of circuit courts requires at least some level of scienter on the part of the debtor, and another camp imposes nondischargeable liability upon individuals acknowledged to be "innocent debtors." By joining this later camp, the Ninth Circuit puts itself at odds with the language of the statute as well as decisions of this Court requiring a least some level of scienter, including *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013), *Field v. Mans*, 516 U.S. 59 (1995) and *Neal v. Clark*, 95 U.S. 704, 706 (1877). The deepening split of authorities implicates Congress' constitutional mandate to establish uniform laws on bankruptcy. U.S. Const. art. I, § 8, cl. 4.

Moreover, the Ninth Circuit's decision, and all of the circuit courts' decisions imposing nondischargeable

liability without scienter, are based upon the problematic opinion in *Strang v. Bradner*, 114 U.S. 555 (1885), which is misinterpreted to cover issues that were not part of the Court's actual analysis. See, *e.g.*, *Hardie v. Swafford Bros. Dry Goods Co.*, 165 Fed. 588, 589–90 (1908) (discussing *Strang* but declining to deny discharge to an innocent debtor for the fraud of another). The split of authorities is driven largely by conflicts between *Strang* and other opinions of this Court. Unless this Court steps in, competing interpretations of Section 523(a)(2)(A) and *Strang* will continue to fracture the circuit courts.

The issue is important. In fact, the issue potentially impacts every joint transaction or endeavor that may be construed as a partnership, including transactions involving married persons and couples, even the sale of a family home. Moreover, the aforesaid split of authorities among circuit courts makes the outcome depend upon geography and happenstance rather than the merits or substantive law.

In addition, the facts of this case tee up the issue in a straightforward and clear manner that make it an ideal vehicle to clarify the law. As discussed below, the Petitioner was determined to have acted reasonably, not recklessly, and to have had no knowledge of any fraud. Also, the underlying doctrine imputing fraud between partners is not itself at issue; only dischargeability in bankruptcy is at issue. The Petitioner embodies the ideal "innocent partner" without any factual complications or stray legal issues.

2. Facts.

Here, a husband and wife bought a home. Later, the spouses moved out, and the husband handled the sale of their home with his wife's consent but without any substantial involvement on her part. Unbeknownst to the wife, the husband allegedly made false representations to the buyer. Thereafter, the husband incurred a judgment for nondisclosure of material facts, and the wife was subject to the same judgment by imputation.

The husband is David William Bartenwerfer, and the wife is Petitioner Kate Marie Bartenwerfer. The buyer and judgment creditor is Respondent Kieran Buckley.

The bankruptcy court made the following findings of fact, *inter alia*: "When Mr. and Mrs. Bartenwerfer acquired the home located at 549 28th Street, San Francisco, California (the 'Property'), they intended to remodel it." (Pet. App., 37a). "Mr. and Mrs. Bartenwerfer lived in the Property until approximately April 2007, when the renovations made continued use of the Property as a residence impossible." (Pet. App., 38a).

"Managing the renovation of the Property was Mr. Bartenwerfer's full-time job." (Pet. App., 39a). "At all times relevant to this action, Mrs. Bartenwerfer worked elsewhere." (Pet. App., 37a). "Mrs. Bartenwerfer could not recall setting foot on the Property between April 2007 and approximately November 2007, when they put the Property on the market." (Pet. App., 38a).

> She never lived in the renovated Property; she never saw and did not possess or maintain the construction permits; she never interacted with contractors, laborers, architects, or consultants; she never asked for or reviewed construction plans or drawings; and she never asked for or reviewed invoices or estimates for construction work.

(Pet. App., 45a). In November of 2007, Mrs. Bartenwerfer visited the Property with Mr. Bartenwerfer and the listing agent. "[S]he verified whatever information she could by visually inspecting the Property during that visit, such as, for example, confirming visually that the Property had a dishwasher and a range. For everything else, she relied on Mr. Bartenwerfer to confirm orally the accuracy of the information to be disclosed." (Pet. App., 42a). "According to Mrs. Bartenwerfer's testimony, Mr. Bartenwerfer served as her sole source for information concerning the Property, other than what she could verify visually." (*Id.*)

"When asked whether she saw any problems with the Property's windows, Mrs. Bartenwerfer simply said she 'was not aware of any problems.'" (Pet. App., 43a). "[S]he consistently, clearly, and credibly maintained . . . [that] she had no personal knowledge and as to which she could not determine an answer based on her visual inspection, she asked Mr. Bartenwerfer and relied unflinchingly on whatever he told her." (Pet. App., 46a).

Under the circumstances, the bankruptcy court found the Petitioner's lack of participation and knowledge

to be reasonable, as a factual matter, and determined that it was not reckless. (Pet. App., 57a). Accordingly, the court entered judgment in favor of Petitioner and against the Respondent. (Pet. App., 33a).

3. Proceedings.

The spouses commenced a joint case under chapter 7 of the Bankruptcy Code, and the judgment creditor, namely Respondent Buckley, commenced an adversary proceeding before the bankruptcy court alleging, *inter alia*, that the judgment is excepted from the debtors' discharge pursuant to Bankruptcy Code § 523(a)(2)(A). The bankruptcy court eventually entered a nondischargeable judgment against Mr. Bartenwerfer for $539.157.70 as of October 27, 2016, with interest.

Following an earlier appeal and judgment on remand, the bankruptcy court correctly determined that Section 523(a)(2)(A) applies only to a debtor who, at a minimum, knew or should have known of her agent's fraud. (Pet. App., 58a). Accordingly, the court entered judgment in favor of the wife, namely Petitioner Mrs. Bartenwerfer. (Pet. App., 33a). On appeal, the Bankruptcy Appellate Panel agreed. (Pet. App., 18a-24a).

On further appeal, the Ninth Circuit affirmed the Bankruptcy Appellate Panel's decision on a different issue but reversed with respect to the Petitioner, holding expressly that fraud imputed against a debtor is nondischargeable "regardless of her knowledge of the fraud." (Pet. App., 6a). As the first Ninth Circuit opinion to expressly adopt the no-scienter standard, it

should have been published. 9th Cir. Rule 36-2(a). (In addition, it should have been published because it arises from a published opinion of a lower court. 9th Cir. Rule 36-2(e).) Nevertheless, it will surely become the guiding authority in the Ninth circuit unless it is overturned. Fed. R. App. P. 32.1(a); *Plumley v. Austin*, 574 U.S. 1127 (2015) (Thomas, J., and Scalia, J., dissenting from denial of certiorari).

The court remanded the matter to the bankruptcy court with instructions to enter judgment in favor of Respondent and against Petitioner. (Pet. App., 6a). The Petitioner timely petitioned for rehearing *en banc*, and her petition was denied on September 24, 2021 (Pet. App., 60a).

REASONS FOR GRANTING THE PETITION

Circuit courts are split as to whether liability for the fraud of another (specifically, the fraud of an agent or partner) can be barred from discharge under Bankruptcy Code § 523(a)(2)(A) without at least some level of scienter on the part of the debtor. Compare *Walker v. Citizens State Bank (In re Walker)*, 726 F.2d 452, 454 (8th Cir. 1984) (applying "knew or should have known" standard) with *Deodati v. M.M. Winkler & Assocs. (In re M.M. Winkler & Assocs.)*, 239 F.3d. 746, 751 (5th Cir. 2001) (denying discharge without any level of scienter). By barring the Petitioner's discharge for liability arising from the fraud of her husband and partner "regardless of her knowledge of the fraud" (Pet. App., 6a),

the Ninth Circuit's decision below exacerbates and deepens the split of authorities.

Moreover, the decision below is wrong. Liability for the fraud of another cannot be barred from discharge under Section 523(a)(2)(A) without at least a minimal level of scienter on the part of the debtor. *Field v. Mans*, 516 U.S. at 60. Like the decision below, opinions applying the no-scienter rule are flawed because they are based upon a misinterpretation of this Court's decision in *Strang*. *Strang* is inapposite because the opinion assumes away and does not analyze the issue of dischargeability, focusing instead on the underlying imputation of liability between partners. *Strang*, 114 U.S. at 556–60. Even within a few decades of *Strang*, circuit courts understood the decision's limited scope and declined to render liabilities nondischargeable without some level of scienter. See, *e.g.*, *Hardie*, 165 F. at 589–90; *Frank v. Michigan Paper Co.*, 179 F. 776, 779 (4th Cir. 1910). In any event, *Strang* was superseded by statutory amendment and by subsequent decisions of this Court, namely *Bullock* and *Field v. Mans.* Nevertheless, courts in the no-scienter camp will continue to misconstrue *Strang* until this Court clarifies the role that it plays (or does not play) in the jurisprudence of Bankruptcy Code § 523(a)(2)(A).

The issue is important. If the decision below stands, innocent and honest debtors unfortunate enough to unwittingly do business with a fraudster will labor under nondischargeable liability indefinitely, without possibility of relief, for conduct over which they have no control or even knowledge. This is contrary to the

Bankruptcy Code as well as law of our nation, which does not countenance an individual falling into indefinite involuntary servitude by reason of circumstances outside her control and indeed outside of her awareness entirely. *Hardie*, 165 F. at 589–90. The issue potentially impacts every joint endeavor that becomes a partnership, including transactions involving married spouses, even the sale of a family home. For such an important issue, the circuit split of authorities is unfortunate as it makes the outcome depend upon accidents of geography and not upon the merits or differences in substantive law.

The facts of this case tee up the issue in a straightforward and clear manner that makes it an ideal vehicle to clarify the law. As discussed above, the Petitioner was determined to have acted reasonably, not recklessly, and to have had no knowledge of any fraud. (Pet. App., 57a). These findings were not disturbed on appeal. Also, the underlying doctrine imputing fraud between partners is not itself at issue; only dischargeability in bankruptcy is at issue in an isolated, pure form. In other words, the Petitioner embodies the ideal "innocent partner" without any factual complications or stray legal issues, giving this Court a rare opportunity to say with clarity and finality whether liability for the fraud of another can be barred from discharge under Bankruptcy Code § 523(a)(2)(A) without at least some level of scienter on the part of the debtor.

I. The Ninth Circuit's Decision Below Deepens a Split of Authorities Among Circuit Courts.

The decision below deepens a split of authorities among circuit courts. The circuits are grouped roughly into two camps, with those that follow the Eighth Circuit's decision in *Walker*, 726 F.2d at 454 (requiring at least a minimal level of scienter on the part of the debtor before barring discharge for the fraud of another) in one camp pitted against those that follow the Fifth Circuit's decision in *Winkler*, 239 F.3d. at 751 (requiring no act, omission, intent or knowledge). The positions of the two camps are irreconcilable. By joining the *Winkler* camp, the Ninth Circuit aggravates and deepens the split of authorities.

a. The Eighth Circuit Applies the Correct Approach in *Walker*, Requiring at Least a Minimum Level of Scienter Before Barring Discharge to an Innocent Debtor for the Fraud of Another.

The leading case applying the correct rule is *Walker*, 726 F.2d 452. In *Walker*, the Eighth Circuit held that Bankruptcy Code § 523(a)(2)(A) requires that a debtor-principal "knew or should have known" of the fraud of his agent before the resulting liability can be rendered nondischargeable. *Id.* at 454. Although phrased in terms of agency principles, the same goes for general partners acting as agents for the partnership.

Walker acknowledges that "actual participation in the fraud by the principal is not always required[,]" but it is necessary that "the principal either knew or should have known of the agent's fraud" in order for the liability to be barred from discharge. *Id.* The court in *Walker* was careful to explain that the requisite knowledge can be imputed to the debtor-principal "[w]hen the principal is recklessly indifferent to his agent's acts." *Id*. In this matter, the Petitioner was expressly found to have acted reasonably, and not recklessly, despite her lack of knowledge. (Pet. App., 57a).

i. The Requirement of Scienter is Consistent with Statutory Language.

Walker is consistent with the language of the statute and opinions of this Court. In pertinent part, Bankruptcy Code § 727 provides that: "(a) The [bankruptcy] court shall grant the debtor a discharge . . . (b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date" the case was commenced. Bankruptcy Code § 523(a)(2)(A) provides an exception from discharge only for a debtor who incurs "any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud. . . ."

State law may determine whether or not there is underlying liability, but "the issue of nondischargeability [is] a matter of federal law governed by the terms

of the Bankruptcy Code." *Grogan v. Garner*, 498 U.S. 279, 284 (1991). Except for certain narrow exceptions, "[t]here is no federal general common law." *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938). "Application of federal bankruptcy law does not justify the creation of a new federal common law rule." *Norfolk So. R.R. Co. v. Consol. Freightways Corp. (In re Consol. Freightways Corp.)*, 443 F.3d 1160, 1162 (9th Cir. 2006) (declining to create a rule of federal common law regarding constructive trusts involving interstate transportation); see also *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 89 (1994) (Noting the "the runaway tendencies of 'federal common law' untethered to a genuinely identifiable (as opposed to judicially constructed) federal policy.").

The approach in *Walker* is proper because it avoids creating new exceptions from discharge that are not plainly expressed in the statute. "In view of the well-known purposes of the bankrupt law, exceptions to the operation of a discharge thereunder should be confined to those plainly expressed. . . ." *Gleason v. Thaw*, 236 U.S. 558, 562 (1915). Courts have no authority to expand exceptions to discharge beyond what is expressly written in the Bankruptcy Code. "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); see, *e.g.*, *Law v. Siegel*, 571 U.S. 415, 424 (2014) ("The Code's meticulous . . . enumeration of exemptions and exceptions . . . confirms that courts are not authorized to create additional exceptions."). Accordingly, *Walker* represents the proper

approach because it avoids grafting onto the statute an exception from discharge that punishes an innocent and honest debtor for the actions of someone else.

The purpose of the discharge in bankruptcy is to give relief to the "honest but unfortunate debtor." "In determining the meaning of the statute, we look not only to the particular statutory language, but to the design of the statute as a whole and to its object and policy." *Crandon v. U.S.*, 494 U.S. 152, 158 (1990). The chief purpose of the bankruptcy law is to give "to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." *Loc. Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). The Petitioner in this case embodies the honest but unfortunate debtor; she was unquestionably honest in her dealings but unfortunate enough to associate with someone who (allegedly) was not.

Bankruptcy Code § 523(a)(2)(A) requires at least some level of scienter on the part of the debtor. Interpreting the Bankruptcy Act of 1867, this Court held that a similar exception from discharge requires "positive fraud or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud or fraud in law. . . ." *Neal v. Clark*, 95 U.S. at 706. Black's Law Dictionary defines "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.—Also termed *fraud in fact; positive fraud; moral fraud*." FRAUD, Black's Law Dictionary (11th ed. 2019).

ii. Requiring Scienter is Consistent with the Statute's Legislative History.

Requiring scienter is consistent with the legislative history of Bankruptcy Code § 523(a)(2)(A). Specifically, Congress expressly favored *Neal v. Clark* when it enacted Section 523(a)(2)(A) as part of the new Bankruptcy Code. "Subparagraph (A) is intended to codify current law, e.g., *Neal v. Clark* . . . , which interprets 'fraud' to mean actual or positive fraud rather than fraud implied by law." 124 Cong. Rec. H11, 095-96 (Daily ed. Sept. 28, 1978); 124 Cong. Rec. S17, 412-13 (Daily ed. Oct. 6, 1978) (remarks of Rep. Edwards and Sen. DeConcini).

Neither *Strang* nor any alternative interpretations of Bankruptcy Code § 523(a)(2)(A) were mentioned. As discussed below, *Strang* was an aberration that focused on a different issue and was subject to conflicting subsequent opinions of this Court and circuit courts. Accordingly, *Strang* does not qualify for the usual presumption that Congress is aware of the state of the law as there was no established rule. By contrast, when Section 523(a)(2)(A) was created in 1978, there was a well-established rule requiring scienter for fraud to become nondischargeable. *Field v. Mans*, 516 U.S. at 60.

iii. Opinions of This Court Require Scienter.

This Court has expressly held that Bankruptcy Code § 523(a)(2)(A) requires scienter. In *Field v. Mans*, the Court wrote that: "[Section] 523(a)(2)(A) refers to common-law torts. . . ." *Field v. Mans*, 516 U.S. at 60. "The operative terms in § 523(a)(2)(A) . . . 'false pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art. They are common-law terms, and . . . they imply elements that the common law has defined them to include." *Id.* at 69. "[F]raudulent misrepresentation is an intentional tort." *Id.* at 70. (This Court's recent opinion in *Husky Int'l Elecs., Inc. v. Ritz*, 578 U.S. 356 (2016) is not in conflict. *Husky* requires intent, although in that case it was the "actual intent to hinder, delay, or defraud creditors. . . ." *Id.* at 365).

As this Court wrote in *Field v. Mans*, Congress could have created a bar to discharge for unintentional conduct, but it did not. "It would, however, take a very clear provision to convince anyone of anything so odd, and nothing so odd has ever been apparent to the courts that have previously construed this statute, routinely requiring intent. . . ." *Id.* at 68. The circumstances are similar here, where the Petitioner had no knowledge of the fraud and could not have possibly affected the creditor's decisions or circumstances.

The Court recently reaffirmed that the statute requires scienter. In *Bullock*, the Court held that the statutory language of the Bankruptcy Code's exception

from discharge "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" (11 U.S.C. § 523(a)(4)) requires proof of a "culpable state of mind . . . involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant . . . behavior." *Bullock*, 569 U.S. at 269. In particular, the Court determined that the word "defalcation," which some courts had held lacks any requirement of scienter, in fact requires a level of scienter similar to its "statutory neighbors," namely "fraud," "embezzlement" and "larceny." *Id.* at 274. Although decided in the context of Bankruptcy Code § 523(a)(4), the Court reaffirmed the principal that fraud requires at least some level of scienter.

b. In *Winkler*, the Fifth Circuit Misinterprets the Statute to Bar an Innocent Debtor's Discharge for the Fraud of Another Despite the Absence of Any Act, Omission, Intent or Knowledge.

In the decision below, the Ninth Circuit joins circuit courts that apply a *per se*, strict liability rule. The leading case is the Fifth Circuit's decision in *Winkler*. In *Winkler*, the court wrote: "[W]e hold that § 523(a)(2)(A) prevents an innocent debtor from discharging liability for the fraud of his partners, regardless whether he receives a monetary benefit." *Id.* at 751.

Winkler is the wrong approach because, among other problems, it grafts onto the statute an extension

based upon judge-made common law that is not found anywhere in the statute itself. A court lacks authority to go beyond the text of the statute. *A verbis legis non est recedendum*. "We have not traveled, in our search for the meaning of the lawmakers, beyond the borders of the statute." *United States v. Great Northern Ry.*, 287 U.S. 144, 154 (1932) (Cardozo, J.). Likewise, courts lack authority to stretch a statute into areas that the statute does not cover. *Casus omissus pro omisso habendus est.* "To supply omissions transcends the judicial function." *Iselin v. United States*, 270 U.S. 245, 251 (1926) (Brandeis, J.). Courts are not to speculate on what the legislature would have wanted but did not provide. *Ebert v. Poston*, 266 U.S. 548, 554 (1925) (Brandeis, J.). "The question . . . is not what Congress 'would have wanted' but what Congress enacted." *Argentina v. Weltover, Inc.*, 504 U.S. 607, 618 (1992) (Scalia, J.). The discharge in bankruptcy, and its exceptions, apply to the debtor alone. There is nothing in the statute or the Bankruptcy Code providing that a debtor's discharge can be eliminated, unilaterally, by the acts of someone else, without her participation or even knowledge.

i. The Strict-Liability Approach Relies Upon a Misinterpretation of this Court's Opinion in *Strang*.

Winkler's key flaw is that it relies upon *Strang* to support its holding. In fact, *Strang* is inapposite; the opinion simply assumes away the issue of dischargeability without any analysis or discussion. The bulk of the opinion in *Strang* is concerned with whether Mr.

Strang, a partner in a law firm, should receive a discharge under the Bankruptcy Act of 1867. In fact, the Court found that Mr. Strang had committed intentional fraud. "If Strang's conduct does not constitute positive fraud, or fraud in fact, involving intentional wrong, it is difficult to conceive what circumstances would have amounted to fraud of that character." *Strang*, 114 U.S. at 560. Accordingly, Mr. Strang could not discharge the liability.

Then, in the opinion's final paragraph, the Court briefly considered whether two of Mr. Strang's partners should be liable for fraud by imputation. *Id.* at 561. The Court determined that they should. *Id.*

The opinion does not continue. Having determined that the partners are liable for fraud by imputation, it is simply assumed—without authority or analysis—that the liability is nondischargeable. *Id*. It appears that the Court did not actually consider the particular issue, perhaps because it was not raised on appeal, the parties having elected to focus their arguments on the underlying liability for fraud, which occupies most of the opinion.

Even circuit court opinions issued relatively soon after *Strang* recognize that scienter on the debtor's part is required despite the holding in *Strang*. Ironically, an opinion of the Fifth Circuit (which later decided *Winkler*) provides an eloquent explanation for why *Strang* does not apply to an innocent debtor. In *Hardie*, the court declined to deny an innocent debtor's discharge on the basis of his partner's fraud. *Hardie*,

165 F. at 590. Discussing *Strang*, the court explained that "the liability of the innocent partner for the torts of the wicked partner committed within the scope of the partnership is based on the application of the principles of agency, and is restricted to pecuniary liability alone." *Id*. at 590. "Since the days of Queen Anne[,] the discharge of the prima facie honest bankrupt and his future estate and effects has been provided for in every bankruptcy law. . . . " *Id.* (citations omitted). The court noted that all of the exceptions from discharge (except one for filing serial bankruptcy cases) "are based on criminal conduct, or actual dishonesty quasi criminal in nature. . . ." *Id*. Accordingly, "discharge of the honest bankrupt is favored, and the opposition . . . is burdened with the necessity of bringing the inculpatory facts alleged strictly within the exceptions enumerated in the law." *Id.*; see also *Frank v. Michigan Paper*, 179 F. at 779 (discussing *Strang* but affirming an innocent partner's discharge in bankruptcy) (reviewing authorities). Notably, the Fifth Circuit failed to consider *Hardie* in its decision in *Winkler*.

In light of the many other opinions of this Court requiring at least some level of scienter before a debt for fraud can be rendered nondischargeable (namely, *Bullock, Field v. Mans* and *Neal v. Clark*), *Strang* should be considered to be either not on point or an aberration in need of clarification. In either event, misapplications of *Strang* will continue unless this Court steps in.

ii. *Strang* was Superseded by Statutory Amendments.

In any event, *Strang* has been abrogated by statutory amendment. The well-reasoned *en banc* opinion of the Bankruptcy Appellate Panel for the Ninth Circuit in *Sachan v. Huh (In re Huh)*, 506 B.R. 257 (B.A.P. 9th Cir. 2014) fits *Strang* into the proper historical perspective. Reviewing more than 100 years of jurisprudence, the court explained that: "The apparent contradictions between the *Neal* and *Strang* decisions are best explained in light of the late nineteenth century view as to what relief a debtor was entitled to in bankruptcy." *In re Huh*, 506 B.R. at 264. "Unlike the current Bankruptcy Code, the provisions of the 1867 Act were not liberally construed in favor of debtors. Obtaining a discharge in bankruptcy proved exceedingly difficult; less than one-third of debtors obtained one." *Id*. The court traced the history of exceptions to discharge and found that those provided in the Bankruptcy Act of 1867 were considerably broader than those under the later Bankruptcy Act of 1898. *Id.* Continuing the same trend, today's "Bankruptcy Code embodies a shift in the fundamental policies and purposes of bankruptcy law. Among other changes, the concept of the discharge under the Bankruptcy Code is much more expansive." *Id*.

In other words, in its progress from the Bankruptcy Act of 1867 to the Bankruptcy Code, the bankruptcy law has developed to abrogate *Strang* and preclude imposing a nondischargeable debt for the fraud of another upon an innocent debtor. Certainly,

the language of the Bankruptcy Code controls over any interpretation of the Bankruptcy Acts of 1867 and 1898. "The starting point in discerning congressional intent is the existing statutory text . . . and not the predecessor statutes." *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) (citation omitted); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 10 (2000) ("[W]hile pre-Code practice informs our understanding of the language of the Code . . . , it cannot overcome that language." Citation and internal quotation marks omitted). As discussed above, courts lack the authority to graft judge-made policy onto federal statutes. "Achieving a better policy outcome . . . is a task for Congress, not the courts." *Id.* at 13–14.

iii. *Strang* is Inconsistent with Subsequent Opinions of this Court.

Moreover, *Strang* has been effectively overruled by subsequent opinions of this Court. The Ninth Circuit's own Bankruptcy Appellate Panel recognizes that *Strang* was effectively overruled by *Kawaauhau v. Geiger*, 523 U.S. 57 (1998) and *Bullock*. "The *Geiger* and *Bullock* decisions appear to cut strongly against applying imputed fraud under § 523(a)(2)(A) to except a debt from discharge in the absence of some showing of culpability on the part of the debtor." *In re Huh*, 506 B.R. at 266–67 (citations omitted). Moreover, *Strang* is in direct conflict with the Court's decision in *Field v. Mans*, expressly requiring intent under Bankruptcy Code § 523(a)(2)(A). *Field v. Mans*, 516 U.S. at 68. These well-known decisions—*Bullock, Geiger* and *Field*

v. Mans—are discussed above, and the discussion is not repeated here.

At least one decision of this Court, issued relatively soon after *Strang*, appears to directly conflict. In *Schall v. Camors*, 251 U.S. 239 (1920), the Court held that a creditor was not entitled to realize upon claims against individual partners in bankruptcy based upon a fraud that was chargeable to another partner or even to the partnership itself. *Id.* at 254–55. This is due to the Court's interpretation of the Bankruptcy Act of 1898 and how it treated partnership debts. For example, in *United States v. Kaufman*, 267 U.S. 408 (1925), the Court explained that a judgment against an individual partner in bankruptcy does not reach all of the partnership's asset, as if each partner were liable on the same debt. "The intention of Congress that the partnership assets shall be first applied to the satisfaction of the partnership debts, and that only the interests of the partners in the surplus remaining after the payment of partnership debts shall be applied in satisfaction of their individual debts, is plain." *Id.* at 412. *Schall* and *Kaufman* do not mention *Strang*, but they should control as their analysis of the issue is much more thorough. This is not to say that *Schall* or *Kaufman* would be correct if decided under today's Bankruptcy Code, but there can be no doubt that they conflict with the holding in *Strang*.

* * *

The confusion among circuit courts is manifest. Courts generally follow either *Walker* or *Winkler*,

although there are some that apply an alternative "receipt of benefits" test, not at issue here. See *In re Huh*, 506 B.R. at 255–56; *BancBoston Mortg. Corp. v. Ledford (In re Ledford)*, 970 F.2d 1556, 1561–62 (6th Cir.1992), cert. denied, 507 U.S. 916 (1993). *Walker*'s "knew or should have known" standard is expressly followed by the Seventh Circuit in *Sullivan v. Glenn*, 782 F.3d 378, 381 (7th Cir. 2015) (Posner, J.), cert. denied, 577 U.S. 1029. A similar standard is applied by the Second Circuit in *In re Lovich*, 117 F.2d 612, 615 (2d Cir. 1941), which *Walker* cites for support, and by the Fourth Circuit in *Levy v. Indus. Fin. Corp.*, 16 F.2d 769, 773 (4th Cir. 1927) ("It is well settled that a false statement in writing by a member of a partnership . . . is available to prevent the discharge of the partner making the false statement, although it will not prevent the discharge of innocent partners.") (collecting authorities), aff'd, 276 U.S. 281 (1928). The split of authorities is expressly recognized in the *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Bonnanzio (In re Bonnanzio)*, 91 F.3d 296, 302 (2d Cir. 1996) and *Warthog, Inc. v. Zaffron (In re Zaffron)*, 303 B.R. 563, 572 (Bankr. E.D.N.Y. 2004).

By joining the camp lead by the Fifth Circuit, the Ninth Circuit deepens a problematic split of authorities among several circuit courts. With the circuit courts entrenched in irreconcilable camps, it is necessary for this Court to step in.

II. The Decision Below was Wrongly Decided.

The decision below was wrongly decided. Like *Winkler*, the Ninth Circuit's decision below is flawed because it relies upon *Strang* (Pet. App., 5a-6a). The decision below also relies upon *Impulsora Del Territorio Sur, S.A. v. Cecchini (In re Cecchini)*, 780 F.2d 1440 (9th Cir. 1986), which itself relies upon *Strang*. *Strang* and *Cecchini* are, in fact, the only authorities that the Ninth Circuit cites in support of its holding. (Pet. App., 6a). The problems with *Strang* are discussed above and not repeated here.

Cecchini relies upon *Strang* and suffers similar problems. Specifically, *Cecchini* glosses over the issue of nondischargeability and is not on point. *Id.* at 1440. Moreover, *Cecchini* was wrongly decided and was effectively overruled by this Court's decisions in *Geiger* and *Bullock*.

In *Cecchini*, the Ninth Circuit considered whether the liability of one partner, who intentionally converted a customer's prepayments, could be imputed to another partner (who benefitted from the transaction) such that his liability would be barred from discharge under Bankruptcy Code § 523(a)(6). *Id.* at 1442. It is important to note that Section 523(a)(6) excepts from discharge liabilities for "willful and malicious injury" and is not equivalent to Section 523(a)(2)(A). In the final paragraph of the six-page opinion in *Cecchini*, the court held that liability for conversion could be imputed to an innocent partner without any evidence of the debtor partner's direct involvement. *Id.* at 1444.

Then, in a single sentence devoid of analysis, the court assumed away the issue and jumped directly to the conclusion that such an innocent partner's liability is nondischargeable. *Id.*

Cecchini was overruled by this Court's opinion in *Kawaauhau v. Geiger*, 523 U.S. 57 (1998). Interpreting Bankruptcy Code § 523(a)(6), the Court in *Geiger* determined that "willful and malicious injury" requires intent to cause injury and that recklessness and negligence are insufficient. *Geiger*, 523 U.S. at 64.

In any event, the *Cecchini* opinion was wrongly decided. Approximately one year after issuing the opinion in *Cecchini*, the Ninth Circuit reconsidered its holding and called it into question. "Were we to rely on strict agency or partnership principles, we might be forced to conclude that Cecily Lansford's debt is nondischargeable regardless of her knowledge of the fraud or her own culpability." *La Trattoria, Inc. v. Lansford (In re Lansford)*, 822 F.2d 902, 904–05 (9th Cir. 1987). "In light of the bankruptcy code's purpose of providing a fresh start . . . , we believe the breadth of the proposition stated in *Cecchini* deserves more thorough consideration. . . ." *Id*. citing *Walker*, 726 F.2d at 454. The court in *Lansford* ultimately avoided applying *Cecchini*, but the court's comments—authored by eventual Supreme Court Justice Kennedy—make clear that the scope of *Cecchini* is questionable at best.

Another subsequent decision of the Ninth Circuit departs from *Cecchini*. Although *Lansdowne v. Cox*

(In re Cox), 41 F.3d 1294 (9th Cir. 1994) was decided in the context of a debtor's overall discharge under Bankruptcy Code § 727, its reasoning is instructive. The facts of *Cox* are very similar to the facts here, if not even less favorable. Specifically, the wife in *Cox* signed numerous transactional documents, became a co-owner of at least fourteen parcels of real property with her husband, was a partner in at least two partnerships with her husband, and was an officer or director in at least four of their corporations. *Id.* at 1297. Nevertheless, the bankruptcy court found that: "Ms. Cox had no knowledge of her husband's business affairs, did not participate in the transfer or removal of assets, and lacked an actual intent to hinder, delay or defraud a creditor or an officer of the estate." *Id.* Citing both *Lansford* and *Walker*, the court applied the rule that, for fraud imputed to an innocent partner to become nondischargeable, the debtor must have known or should have known of her partner's fraud. *Id*. Accordingly, the court declined to deny Ms. Cox her discharge.

Accordingly, the decision below is wrong. Specifically, the decision expressly rejects *Walker*, relies upon *Strang* and *Cecchini* and fails to take account of contrary authorities.

III. The Deepening Split of Authorities Implicates Congress' Constitutional Mandate to Establish Uniform Laws on Bankruptcy.

The deepening split of authorities discussed above implicates Congress' constitutional mandate to establish uniform laws on bankruptcy. "The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. . . ." U.S. Const. art. I, § 8, cl. 4. In other words, if Congress exercises its power to enact bankruptcy laws, they must be uniform throughout the United States. To be sure, Petitioner does not argue that Bankruptcy Code § 523(a)(2)(A) is unconstitutional, but the disparate and incompatible interpretations applied by the circuit courts frustrate Congress' proper exercise of its authority. If the Ninth Circuit's decision stands, then innocent debtors will be subject to dramatically different outcomes based only upon geographical happenstance.

IV. The Question Presented is Important.

The question presented is important. In the decision below, the Ninth Circuit imposes nondischargeability upon an innocent debtor for the fraud of another without any act, omission, intent or knowledge of the debtor's own. Not only is this contrary to the letter and purpose of the Bankruptcy Code, it is also contrary to the law of our nation, which does not countenance an individual falling into indefinite involuntary servitude by reason of circumstances outside her control and indeed outside of her awareness entirely.

> In this country, since the abolition of imprisonment for debt, the punishment of the innocent principal or the innocent partner for the wrong committed by the agent or partner has not been pushed further than to affect business reputation and to impose pecuniary liability.

Hardie, 165 F. 590. The decision below applies a *per se* rule that admits of no exception for an innocent debtor, who is honest but unfortunate enough to unwittingly do business with a fraudster.

Viewed another way, the Ninth Circuit's decision infringes upon the rights of individuals to freely associate and contract with one another without a court intervening to make innocent participants liable for the actions of others based upon judge-made law not found in any statute. The issue potentially impacts every joint transaction or endeavor that may be construed as a partnership, including transactions involving married persons and couples, even the sale of a family home. If the decision below stands, the innocent debtor will labor under a nondischargeable judgment indefinitely, without possibility of relief, for conduct over which she had no control or even knowledge.

V. This Case is an Ideal Vehicle for Resolving the Split of Authorities.

This matter presents uniquely simple and clear holdings and facts. The Ninth Circuit's decision below squarely determines that the Petitioner is subject to a

nondischargeable liability imputed to her "regardless of her knowledge of the fraud" (Pet. App., 6a) in the context where the bankruptcy court expressly found her to have behaved reasonably and not recklessly (Pet. App., 57a). Moreover, there is no challenge to the underlying partnership and agency principles; there is no dispute that the Petitioner and her husband are deemed to have been partners, leaving only the dischargeability issue isolated and ripe for resolution.

In other words, the Petitioner perfectly embodies the "innocent partner" for the purposes of applying Bankruptcy Code § 523(a)(2)(A) without factual complications or stray legal issues. Accordingly, this matter is ideally situated for resolution by a clear legal analysis that will provide a much-needed guide to circuit courts, district courts and bankruptcy courts.

CONCLUSION

In light of the foregoing, this petition for a writ of certiorari should be granted.

Respectfully submitted,

IAIN A. MACDONALD
Counsel of Record
RENO F.R. FERNANDEZ III
MACDONALD FERNANDEZ LLP
221 Sansome Street
San Francisco, CA 94104
(415) 362-0449
iain@macfern.com

Attorneys for Petitioner
Kate Marie Bartenwerfer

December 17, 2021