No. 21-908

IN THE
Supreme Court of the United States

KATE MARIE BARTENWERFER,

Petitioner,

v.

KIERAN BUCKLEY,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICI CURIAE LAW PROFESSORS IN SUPPORT OF PETITIONER

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STATEMENT OF INTEREST[1]

Amici curiae respectfully file this brief in support of the Petitioner (the "Petitioner"). *Amici,* whose names and affiliations are set forth in alphabetical order in the attached Appendix, are law professors who have devoted their careers to teaching, studying, and writing about, *inter alia*, the text, structure, legislative history, and policy objectives of the Bankruptcy Code (the "Code"), as well as on the practical economic impact of the bankruptcy system and society. Accordingly, *amici* have a strong interest in the proper interpretation of the Code and the effective implementation of the public policies bankruptcy law is designed to promote.

INTRODUCTION AND SUMMARY OF ARGUMENT

The U.S. Court of Appeals for the Ninth Circuit (the "Ninth Circuit") erred in this case by misconstruing bedrock principles of the U.S. Bankruptcy Code (the "Code") in holding that Section 523(a)(2)(A) of the Code ("Section 523(a)(2)(A)") bars an individual honest and innocent debtor from obtaining a discharge for a debt arising from the fraud of another, such as a partner or an agent, by imputation, even though the honest and innocent

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[1] Counsel for all parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no party or their counsel made any monetary contribution toward the preparation or submission of this brief.

debtor did not commit any act, make any omission, possess any intent, or possess any knowledge regarding the fraud committed by the debtor's partner or agent. Specifically, in this case, the Ninth Circuit held that Section 523(a)(2)(A) prevented Mrs. Bartenwerfer from obtaining a discharge from a California state court tort judgment based on her husband's fraud, even though she neither knew nor should have known of her husband's fraud.[2]

By seriously misconstruing Section 523(a)(2)(A) and the public policy underlying the Code, the Ninth Circuit's holding denied a discharge to the very person the Code is meant to protect from potential life-long debt—the "honest but unfortunate" debtor. In so holding, the Ninth Circuit incorrectly reversed the decision of the Bankruptcy Appellate Panel for the Ninth Circuit. If this Court does not reverse the Ninth Circuit's erroneous decision, a disastrous consequence will follow. An innocent and honest debtor such as

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[2] The issue in this case is not whether Mr. Bartenwerfer's fraud could be imputed to his wife under applicable state partnership law or agency law, making her jointly and severally liable for his fraud as his "partner" in the partnership. Instead, the issue is whether Section 523(a)(2)(A) prevents Mrs. Bartenwerfer from obtaining a discharge under the Code for that imputed fraud liability if she neither knew nor should have known of her husband's fraud. A state court's final judgment as to the existence of party's fraud does not control "the interpretation of exceptions to discharge under the [Code], while informed by relevant state law, ultimately is a matter of federal law." *In re Huh*, 506 B.R. 257, 272 (B.A.P. 9th Cir. 2014). *Amici* question whether the Bartenwerfers' co-ownership of the house they later renovated and sold amounts to a partnership for partnership law purposes. However, as that is not an issue before this Court, we will not address it in this brief.

Mrs. Bartenwerfer, could be saddled with a life-long nondischargeable debt simply based on her honest but unfortunate agency or partnership relationship with an unknown fraudster, over which she had no control or power.

BACKGROUND

A. Fresh Start

As this Court has recognized, two bedrock principles underlie the Code: (i) the equitable distribution of the debtor's assets to its creditors; and (ii) the granting of a "fresh start" to the "honest but unfortunate" debtor. *See Grogan v. Garner*, 498 U.S. 279, 286-87 (1991); *BFP v. Resol. Tr. Corp.*, 511 U.S. 531, 563 (1994).[3] Section 727(a) provides that "The [bankruptcy] court shall grant the debtor a discharge". 11 U.S.C. § 727(a). Likewise, Section 727(b) provides "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. . . ." 11 U.S.C.

[3] There are other discharge provisions of the Code that apply in different types of bankruptcy cases such as chapter 11 cases, chapter 12 cases, and chapter 13 cases. *See e.g.*, 11 U.S.C.A. §§ 1141(d)(1)(A), 1192, 1228(a), 1328(a). However, due to the cross-references to Section 523(a)(2) located within the other Code chapters, the Court's decision in this case will have precedential effect regarding the ability of individual debtors to discharge debt resulting from imputed fraud liability. *See* 11 U.S.C.A. §§ 1141(d)(2), 1228(a)(2), 1328(a)(2). In this brief, *Amici* focus on the discharge contained in Section727(a), as the Bartenwerfers filed a chapter 7 case and sought a discharge under Section 727.

§727(b). As this Court has recognized, the ability of an honest debtor to obtain a discharge should be construed broadly. *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998). Generally, obtaining a discharge under chapter 7 of the Code involves a rigorous process through which the debtor must make robust detailed disclosures regarding: (i) his or her assets; (ii) his or her debts; and (iii) any all transfers he or she made to any other party within at least two years prior to the bankruptcy filing. Likewise, the discharge is granted only after all of the debtor's "non-exempt" assets are distributed to his or her creditors.

B. Exceptions to Discharge

The ability of an individual debtor to obtain a "fresh start" by discharging its debts that existed prior to its bankruptcy filing, however, is subject to certain limitations, commonly referred to as the "exceptions to discharge." *See* 11 U.S.C. § 727(b). There are 21 types of debts that cannot be discharged under the exceptions to discharge. 11 U.S.C. § 523(a)(1)-(a)(19). The underlying policy of the exceptions to discharge is, *inter alia*, "to protect the creditor from a dishonest and fraudulent debtor." *In re Anderson*, 29 B.R. 184, 191 (Bankr. N.D. Iowa 1983).

Other exceptions to discharge, such as the exceptions that apply to, *inter alia*, taxes, alimony, and student debt are based on public policy reasons related to "the type of debt rather than the debtor's actions" involving moral turpitude. *See* Stephen W. Sather, *Bullock and the Requirement of Scienter in Dischargeability Actions*, 32 AM. BANKR. INST. J. 16 (Sept. 2013) (discussing exceptions to discharge).

Only three exceptions to discharge require an objecting creditor to file an adversary proceeding arguing that the relevant debt is nondischargeable. *See* 11 U.S.C. § 523(c) (requiring filing of a complaint regarding debts falling under Sections 523(a)(2), (4) and (6)). One of these nondischargeable debts, the proper interpretation of which is central to this case, is "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. . . ." 11 U.S.C. § 523(a)(2)(A).

Courts should construe exceptions to discharge narrowly against the objecting creditor, and liberally in favor of the debtor. *See Kawaauhau*, 523 U.S. at 62 (1998); see also 4 Collier On Bankruptcy ¶523.05 (2010). A different construction would be wholly inconsistent with the liberal spirit in favor of a fresh start that is central to the Code. 4 Collier On Bankruptcy ¶523.05 (2010).

C. The Ninth Circuit's Decision

A couple, the Bartenwerfers, co-owned a home (the "House"). *In re Bartenwerfer*, 596 B.R. 675, 677-80 (Bankr. N.D. Cal. 2019).[4] They lived in the House for a short period of time, and later moved out of the House, intending to renovate it and later sell it. *Id.*

[4] At the time they purchased the home, the Bartenwerfers were not yet married. *See In re Bartenwerfer*, 596 B.R. 675, 677-80 (Bankr. N.D. Cal. 2019). They married at some point after buying the home, but before selling it. *Id.* For purposes of simplicity, this brief refers to the couple as the "Bartenwerfers".

Mr. Bartenwerfer's "full-time job" was overseeing these renovations. *Id.* Mrs. Bartenwerfer, on the other hand, was not involved in managing or overseeing these renovations. *Id.* The Bartenwerfers later sold the House to Kieran Buckley (the "Buyer"). *Id.*

As part of the real estate sale, the Bartenwerfers signed a standard disclosure statement routinely signed by sellers in residential real estate transactions. *Id.* The Bartenwerfers did not disclose any defects related to the House on that disclosure statement. *Id.* After the sale, the Buyer discovered that the House had various problems associated with it, including, but not limited to, leaks, issues with open permits, a violation, and improperly functioning windows. *Id.* The Buyer then successfully brought a lawsuit against the Bartenwerfers in state court for failing to disclose these problems with the House, and obtained a judgment against them. *In re Bartenwerfer*, 860 Fed. Appx. 544, 546 (B.A.P. 9th Cir. 2020).[5]

The Bartenwerfers later filed a chapter 7 bankruptcy petition, seeking to: (i) liquidate their then owned non-exempt assets to pay their creditors; and (ii) obtain a discharge consistent with the "fresh start" policy underpinning the Code. *See In re Bartenwerfer*, 596 B.R. at 676-77. The Buyer then filed an adversary proceeding, in which it argued,

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[5] Specifically, the jury found in favor of the Buyer with respect to his claim for nondisclosure of material facts. *In re Bartenwerfer*, 860 Fed. Appx. 544, 546 (B.A.P. 9th Cir. 2020). The jury, however, rejected the Buyer's intentional misrepresentation claim. *Id.*

inter alia, that pursuant to Section 523(a)(2)(A), the Bartenwerfer's debt was non-dischargeable because it resulted from a false representation or actual fraud. *Id.*

The bankruptcy court later determined that Mr. Bartenwerfer's debt to the Buyer was not dischargeable under Section 523(a)(2)(A) because he knowingly made fraudulent misrepresentations when he failed to disclose defects related to the House on the disclosure form.[6] The bankruptcy court further noted that Mr. Bartenwerfer's fraud was imputed to Mrs. Bartenwerfer under applicable partnership law. The bankruptcy court held, however, that Mrs. Bartenwerfer was entitled to a discharge because she neither "knew nor had reason to know" of her husband's fraudulent misrepresentations to the Buyer. The Ninth Circuit BAP, in an unpublished decision, later affirmed the bankruptcy court's decision. *In re Bartenwerfer*, 2020 WL 1970506 (B.A.P. 9th Cir. 2020).

The Buyer then appealed the Ninth Circuit BAP's decision to the Ninth Circuit. *In re Bartenwerfer*, 860 Fed. Appx. at 544-45. In a short unpublished opinion of approximately four pages in length, the Ninth Circuit reversed the lower court's holding,[7] and held that the debt based on Mr. Bartenwerfer's fraud was

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[6] This Bankruptcy Court decision followed an earlier appeal and judgment on remand. For purposes of brevity, *amici* only discuss the portions of this case's procedural history that are relevant to the issue before this Court.

[7] The Ninth Circuit affirmed the Ninth Circuit BAP's decision with respect to a different issue unrelated to the instant matter before this Court, and that issue will not be addressed here.

imputed to Mrs. Bartenwerfer. *Id*. at 546-47. The Ninth Circuit further held that, as a result, Mrs. Bartenwerfer could not obtain a discharge of that debt, even though she neither "knew nor should have known" of Mr. Bartenwerfer's fraud. *Id*. This holding merely occupied one paragraph of the Ninth Circuit's very short decision, and took the form of a conclusory statement lacking any substantial analysis. *Id*.

D. *Strang*

In reaching its faulty conclusion, the Ninth Circuit erroneously relied on a four-page decision issued by this Court over 136 years ago. *Id*.; *Strang v. Bradner*, 114 U.S. 555, 561 (1885).[8] *Strang* applied Section 33 of the Bankruptcy Act of 1867 (the "1867 Act"), which was a predecessor to current Sections 523(a)(2)(A) and (B) of the Code, and provided that "no debt created by the fraud or embezzlement of the [debtor] . . . shall be discharged . . . . Bankruptcy Act

[8]In support of its erroneous holding, the Ninth Circuit also cited to *Impulsora Del Territorio Sur, S.A. v. Cecchini (In re Cecchini)*, 780 F.2d 1440, 1444 (9th Cir. 1986). *Cecchini* largely addressed the exception to discharge contained in Section 523(a)(6) relating to a debt based on "willful and malicious injury" *Id*. at 1442-44. This Court overruled *Cecchini's* holding on that issue in *Kawaauhau v. Geiger*, 523 U.S. 57 (1998). *Cecchini*, like *Strang*, in the final paragraph of its holding: (i) imputed Cecchini's "knowledge and intent" to his partner, Robustelli, who allegedly neither knew nor should have known of Cecchini's malicious actions; and (ii) denied Robustelli a discharge under Section 523(a)(6). *In re Cecchini*, 780 F.2d at 1444. *Cecchini's* discussion and holding regarding denial of Robustelli's discharge was, like the discussion of the Ninth Circuit and *Strang*, conclusory and bereft of any substantial analysis. *Cecchini's* holding, therefore, was erroneous and should not be followed.

of 1867, ch. 176c, 14 Stat. 517, 533 (1867).

Similar to the Ninth Circuit's holding, the Court's holding in *Strang* consisted solely of a conclusory statement occupying only the last paragraph of its decision stating that, in the context of a partnership, an innocent partner who had no knowledge of his other partner's fraudulent misrepresentations: (i) was liable therefor because partners are jointly and severally liable for each other's acts undertaken in connection with partnership; and (ii) as a result, could not obtain a discharge under Section 33 of the 1867 Act. *Strang*, 114 U.S. at 561-62. Although *Strang's* holding was correct with respect to partnership law regarding the imputation of liability from one partner to another, it was bereft of any analysis supporting its holding that deprived an innocent partner of his or her discharge.

E. Circuit Split

Following the enactment of the Code in 1978, and prior to the Ninth Circuit's decision in this case, a circuit split developed on whether a debtor liable for a partner's or agent's fraud could obtain a discharge under the Code when that debtor: (i) did not have any knowledge of its partner's or agent's fraud; and (ii) was not on inquiry notice of its partner's or agent's fraud. *See* Theresa J. Pulley Radwan, *Determining Congressional Intent Regarding Dischargeability of Imputed Fraud Debts in Bankruptcy*, 54 MERCER L. REV. 987, 1008 (Spring 2003) (discussing circuit split). Courts in one group allow an innocent debtor with imputed fraud liability to obtain a discharge if the debtor can demonstrate that it neither knew nor

should have known of its partner's or agent's fraud. *Id.* Courts in the opposing group generally deny a discharge to an innocent debtor regardless of whether that debtor knew or should have known of his partner's or agent's fraud. *Id.*

In 1984, the Eighth Circuit employed the correct analysis and approach by holding that, in the context of an agency relationship, Section 523(a)(2)(A) requires a debtor-principal either "knew or should have known" of its agent's fraud, before Section 523(a)(2)(A) could render the debtor-principal's liability nondischargeable. *Walker v. Citizens State Bank (In re Walker)*, 726 F.2d 452, 454 (8th Cir. 1984). Although decided in the context of an agency relationship, *Walker's* holding applies equally in the context of partnerships. Indeed, as a principal is liable for the acts of its agent done in connection with the agency relationship[9], a partner is liable for the acts of its partners done in connection with the partnership.[10] The Seventh Circuit has followed the

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[9] An agency relationship is defined as: "[T]he fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Restatement (Third) of Agency § 1.01. In an agency relationship, a principal is generally liable for the acts of its agent that occur in the ordinary course of the agency relationship.

[10] A partnership is generally defined as an association of two or more persons who intend to carry on as co-owners a business for profit. *See* RUPA § 202. In a partnership, each partner is generally jointly and severally liable for acts of other partners conducted in connection with the ordinary course of business of the partnership. *See* RUPA §§ 306-307.

reasoning in *Walker*. *See Sullivan v. Glenn*, 782 F.3d 378 (7th Cir. 2015), *cert. denied*, 577 U.S. 1029 (2015).

The Fifth Circuit, in 2001, on the other hand, erroneously relying heavily on *Strang*, mistakenly held that Section 523(a)(2)(A) proscribed an innocent debtor, whose partner's fraud-based liability was imputed to him, from obtaining a discharge, even though he neither "knew nor should have known" of his partner's fraudulent conduct. *Deodati v. M.M. Winkler & Associates (In re M.M. Winkler & Associates*), 239 F.3d 746 , 751 (5th Cir. 2001).[11] As argued below, the Ninth Circuit and *Winkler* misinterpreted Section 523(a)(2)(A). As a result, this Court should reverse the Ninth Circuit's faulty holding.

ARGUMENT

I. THE NINTH CIRCUIT DRASTICALLY MISCONSTRUED SECTION 523(a)(2)(A) BY ERRONEOUSLY RELYING ON *STRANG*, WHICH WAS IMPROPERLY DECIDED

The decision in *Strang*, at minimum, is flawed. Indeed, leading scholars who have written on the issue presented in this case have criticized *Strang's* holding. *See* Steven H. Resnicoff, *Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse?*

[11] In *Winkler*, the issue of whether a debtor must obtain a benefit from its partner's or agent's fraud in order for the exception to discharge contained in Section 523(a)(2)(A) to apply consumed the bulk of the Fifth Circuit's opinion. *See In re M.M. Winkler & Associates*, 239 F.3d at 749-51.

Bankruptcy Dischargeability of Vicarious Debt, 42 CASE WESTERN L. REV. 174, 159-180 (providing detailed criticism of *Strang*); Radwan, *supra*, at 1005-1008 (criticizing Strang). As mentioned above, *Strang* focused its very brief analysis on the imputation of fraud liability from the partner who had committed the fraud to his co-partner(s) under principles of partnership law. It did not provide any analysis in support of its conclusion that Section 33 of the 1867 Act prevented an innocent partner who neither knew nor should have known of his partner's fraud from obtaining a discharge.

Furthermore, the holding in *Strang* is questionable. In 1877, approximately eight years before deciding *Strang*, this Court interpreted Section 33 of the 1867 Act in a different case. *Neal v. Clark*, 95 U.S. 704 (1877). In *Neal*, Griffith Neal purchased bonds from the executor of the estate of William Fitzgerald. *Id.* at 704. Certain purchasers of real estate that was part of Mr. Fitzgerald's estate had executed the bonds, which were secured by mortgages, in favor of the executor. *Id.* The executor later sold those bonds at a discount to Neal. *Id.* At the time of the bond purchase, Neal acted in good faith had no reason to suspect any wrongdoing by the executor, who "was a man of large property and undoubted solvency". *Id.*

Later, Clark became a surety of the estate and brought an action against, *inter alia*, the executor and Neal, arguing that the executor fraudulently wasted estate assets (i.e. *devastavit* of estate) because he: (i) did not have authority to sell the bonds to Neal; and (ii) sold the bonds to Neal at below market value. *Id.*

at 704-05. Neal filed for bankruptcy and sought a discharge. *Id.* at 705. The lower court denied Neal a discharge based on the fraud exception to discharge contained in Section 33 of the 1867 Act. This Court, however, reversed, stating that Congress intended the 1867 Act so that an "honest citizen may be relieved from the burden of hopeless insolvency." *Id.* at 709. For a debt to be nondischargeable because it was based on "fraud", this Court reasoned that the fraud had to be "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement, and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Id.*

Although *Neal* didn't deal with a debtor who was in a partnership or in an agency relationship, *Neal* and *Strang* share the following similarity—They both involved a debtor who acted in good faith, but nevertheless found itself in the unfortunate, and later regrettable, situation of having unknowingly dealt with a fraudster. In *Neal* the fraudster was the executor, while in *Strang* the fraudster was the debtor's partner. The *Strang* decision recognized the connection between the cases and noted that *Neal* defined fraud as "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud or fraud in law, which may exist without the imputation of bad faith or immorality." *Strang*, 114 U.S. at 559.

Strang failed to explain why the honest partner who neither knew nor should have known of his partner's fraud "was guilty of anything more than 'implied fraud or fraud in law,' which was

dischargeable under *Neal*." Resnicoff, *supra*, at 159. *Strang* made no mention of whether the debtor was negligent in supervising his partner who committed fraud. *Id.* Moreover, *Strang* made no mention of the compatibility of its decision with Congress's intent of protecting honest citizens from being subject to a lifetime of nondischargeable debt. *Id.* The denial of a discharge in a bankruptcy proceeding is generally based on: (i) debts arising from conduct of the debtor involving moral turpitude or fraud; or (ii) other debts Congress deemed should be nondischargeable for public policy reasons such as non-payment of taxes, alimony, or child support. *See* Resnicoff, *supra*, at 160-180; Radwan, *supra*, at 1005-1008, 1009-1010, 1013, 1017, 1019, 1022, 1024-25.

Denying a debtor who finds himself or herself in the shoes of Mrs. Bartenwerfer not only frustrates the Code's "fresh start" policy, but also punishes an honest debtor for the fraudulent conduct of another person with respect to which the honest debtor had no knowledge or control. Moreover, such liability is not consistent with recent decisions that have allowed a debtor to discharge debt arising from vicarious liability in other circumstances. *See, e.g., Jones v. Whitacre (In re Whitacre)*, 93 B.R. 584, 585 (Bankr. N.D. Ohio 1988) (refusing to impute a child's intent to parents for discharge purposes); *Ordmann v. Hoppa (In re Hoppa)*, 31 B.R. 753, 754–55 (Bankr. E.D. Wis. 1983) (granting employer discharge for his obligation regarding drunk driving liability of his employee).

Likewise, in the context of other areas of federal law, such as the U.S. Tax Code, Congress has

protected innocent spouses. Under the U.S. Tax Code, spouses who file a joint tax return are generally legally jointly and severally liable for any tax liability owed by either spouse who signed the return. Congress, however, provided an exception for an "innocent spouse" who signs a joint tax return. *See* 26 U.S.C. § 6015(b). Under this provision, the innocent spouse may be relieved of joint liability if, when that spouse signed the joint tax return, he or she did not know (and lacked a reason to know) of his or her spouse's understatement of income. *Id.*

II. EVEN IF *STRANG* WAS PROPERLY DECIDED, WHICH IT WAS NOT, ITS HOLDING DOES NOT APPLY TO MODERN BANKRUPTCY LAW

A. Neither Section 17 of the Bankruptcy Act of 1898, Nor Cases Interpreting It Support the Holding of the Ninth Circuit

The decision in *Strang*, does not survive in modern bankruptcy law. About twenty years after repealing the 1867 Act, which *Strang* purported to interpret, Congress enacted the Bankruptcy Act of 1898 (the "1898 Act"). *See* Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 362-64 (1991). Indeed, approximately three decades after *Strang*, at least two circuits interpreted Section 17 of the 1898 Act, the successor to Section 33 of the 1898 Act, and the predecessor to Section 523(a)(2)(A). *See e.g., Hardie v. Swafford Bros. Dry Goods Co.*, 165 F. 588, 588-92 (5th

Cir. 1908); *Frank v. Michigan Paper Co.*, 179 F. 776, 779 (4th Cir. 1910). Those courts refused to apply *Strang's* holding to innocent debtors who suffered liability for fraud claims by imputation under partnership or agency law, when those debtors neither knew nor should have known of their partner's or agent's fraud. *Id.*

In *Hardie*, an innocent debtor who was a partner in a partnership sought, through his bankruptcy filing, to discharge a debt that was imputed to him based on the fraud of one of his partners. *Hardie*, 165 F. at 588-90. The court in *Hardie* held that the innocent debtor that neither knew nor should have known of his partner's fraud had a right to a discharge. *Id.* at 591-92. In support of its holding, the court in *Hardie* stated:

> 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 busines reputation and to impose pecuniary liability. . . . [T]he release of the honest, unfortunate, and insolvent debtor from the burden of his debts and to restore him to business activity, in the interest of his family and the general public, is one of the main, if not most important, objects of the law." *Id.* at 590-91.

The Fourth Circuit followed the reasoning of *Hardie* when interpreting Section 17 of 1898 Act. *See Frank*, 179 F. at 779 (agreeing with decision in *Hardie*).

B. Section 523(a)(2)(A)'s Legislative History Refutes the Applicability of Imputation to Section 523(a)(2)(A).

Although Section 523(a)(2)(A) stems from Section 17 of the 1898 Act and its predecessor, Section 33 of the 1867 Act, the current version of the Code, which Congress enacted in 1978 "embodies a shift in the fundamental polices and purposes of bankruptcy law." *In re Huh*, 506 B.R. at 264. In addition to "other changes, the concept of discharge under the current [Code] is much more expansive." *Id.* The Ninth Circuit, therefor, erred in following *Strang*. *Strang* did not interpret a provision of the Code. Instead, it interpreted a provision of the 1867 Act, which Congress expressly repealed in 1878, and eventually replaced in 1978 when it enacted the Code. *See* Tabb, supra, at 356-370.

The 1867 Act is readily distinguishable from the current version of the Code. Unlike the current version of the Code, the exceptions to discharge under the 1867 Act were not liberally construed in favor of the debtor. *In re Huh*, 506 B.R. at 264. In fact, under the 1867 Act, it was very difficult to obtain a discharge—at that time, "less than one third of debtors obtained one." *Id.* at 264. Indeed, "the chief difficulty in obtaining a discharge was presented by the extremely long list of grounds for denying the discharge contained in section 29 of the act." *See* Tabb, supra, at 357.

Moreover, the limited legislative history of Section 523(a)(2)(A) does not support the continued

vitality of the holding in *Strang*. The legislative history of Section 523(a)(2)(A) is succinct and provides a very persuasive basis for concluding that Congress did not intend to codify the holding of *Strang* into Section 523(a)(2)(A). *See* Radwan, *supra*, at 998-1000 (discussing legislative history). In the legislative notes associated with its passage, the House of Representatives stated that "[Section 523(a)(2)(A)] is intended to codify the current case law, e.g. *Neal v. Clark*, which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law."[12] A debtor's liability for fraud that arises only as a result of imputing partnership liability on the debtor does not qualify as actual fraud. *See* BLACK'S LAW DICTIONARY 661 (6th ed. 1990) (distinguishing between actual fraud and "fraud in law"). *See also* Restatement (Second) of Torts § 525.

As described in more detail above, *Neal* allowed an innocent debtor vicariously liable for a debt based on the fraud of another party to obtain a discharge. Congressman Edward's statement, therefore, supports the conclusion that Congress did not intend Section 523(a)(2)(A) to prevent an innocent debtor from obtaining a discharge, where that innocent debtor neither knew nor should have known of its partner's or agent's fraud. Furthermore, this statement supports the conclusion that Congress did

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[12] Statement by the Hon. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, Upon Introducing the House Amendment to the Senate Amendment to H.R. 8200 (Sept. 28, 1978), Congressional Record H 11089, 1978 U.S.C.C.A.N. 6436, 6453 (95th Cong., 2d Sess.) (emphasis added). *See also* 124 Cong. Rec. 3998 (1978) (remarks of Sen. DeConcini).

not intend the holding in *Strang* to be applied to the interpretation of Section 523(a)(2)(A). Instead, this statement strongly supports the conclusion that Congress intended this Court's holding in *Neal* to be the "current" law to be used when interpreting Section 523(a)(2)(A).

C. The Statutory Construction Cannon of *Noscitur a Sociis* Cuts Against Imputation.

The "associated-words canon" or the canon of *noscitur a sociis* supports the conclusion that the debtor must either have known or should have known of his partner's or agent's fraud in order for Section 523(a)(2)(A) to prevent the debtor from obtaining a discharge. The canon of *noscitur a sociis*:

> [R]efer[s] to the basic principle that words are given meaning by their context. . . . When . . . any words . . . are associated in a context suggesting that the words have something in common, they should be assigned a permissible meaning that makes them similar. . . . Although most associate-words cases involve listings—usually a parallel series of nouns and noun phrases, or verbs and verb phrases—a listing is not prerequisite. An 'association' [of words in a statute] is all that is required [for this cannon of interpretation to apply].

Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 195-97 (2012).

Moreover, Section 523(a)(2)(C), which Congress enacted regarding, in part, certain consumer debts related to luxury items, expressly refers to Section 523(a)(2)(A) and provides:

> [F]or purposes of [Section 523(a)(2)(A)]— (i) consumer debts owed to a single creditor and aggregating more than $725 for luxury goods or services *incurred by an individual debtor* on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and
>
> (ii) cash advances aggregating more than $1,000 that are extensions of consumer credit under an open-end credit plan *obtained by an individual debtor* on or within 70 days before the order for relief under this title, are presumed to be nondischargeable . . .

The language used by Congress in Section 523(a)(2)(C), which expressly relates to the interpretation of Section 523(a)(2)(A), clearly refers to fraud-based debts incurred or obtained by the debtor, and does not refer to fraud-based debts imputed to a debtor through partnership or agency law. Furthermore in Section 523(a)(2)(B), Section 523(a)(2)(A)'s statutory neighbor, Congress expressly stated that a debtor must bear some responsibility for using a materially written false statement regarding its financial condition which the debtor "*caused to be made* or published with *intent* to deceive." 11 U.S.C.

§ 523(a)(2)(B). Thus, the associated-words cannon supports the conclusion that the Ninth Circuit's decision is erroneous.

III. THIS COURT'S CONSTRUCTION OF COMPANION PROVISIONS TO SECTION 523(a)(2)(A) DO NOT SUPPORT THE NINTH CIRCUIT'S HOLDING.

Although this Court has not addressed the issue of whether Section 523(a)(2)(A) prevents an innocent debtor that neither knew nor should have known of its partner's or agent's fraud from obtaining a discharge, it has issued, within the past 24 years, two decisions addressing companion provisions of Section 523(a)(2)(A)—namely, Sections 523(a)(4) and (a)(6). Most recently, in 2013, this Court held that a showing of bad faith, moral turpitude, or other intentional misconduct on the part of the debtor was required before the exception to discharge contained in Section 523(a)(4) "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" could apply. 11 U.S.C. § 523(a)(4); *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013).

In *Bullock*, Randy Bullock served as a trustee of his father's trust, of which Bullock and his four brothers were beneficiaries. *Id.* at 269. Bullock used trust funds to make loans to himself and his mother. *Id.* at 269-70. Those loans were repaid to the trust with interest. *Id.* Bullock used the proceeds of one of these loans to purchase a mill with his mother. *Id.* Bullock's brothers, however, brought an action against him for breach of fiduciary duty in state court.

Id. Bullock's brothers argued that Bullock engaged in self-dealing by taking the loans from the trust and not sharing the profit made through the investments made with those loans, such as the mill, with them. *Id.* at 270.

Although the state court noted that Bullock did not seem to possess any nefarious intent in making loans to himself from the trust, it: (i) held that he nevertheless breached a fiduciary duty by engaging in self-dealing; (ii) ordered him to "pay the trust 'the benefits he received from his breaches'"; and (iii) imposed a constructive trust on, *inter alia*, Bullock's ownership interest in the mill. *Id.* at 270. Bullock later filed for bankruptcy and sought a discharge for the debt he owed to the other trust beneficiaries. *Id.*

BankChampaign, the successor trustee to the trust, brought an action in the bankruptcy court objecting to Bullock's discharge. *Id.* The bankruptcy court refused to grant Bullock the discharge, and the Eleventh Circuit later affirmed that decision. *Id.* at 270-71. This Court later vacated the Eleventh Circuit's decision. *Id.* at 276. This Court noted that the ordinary definition of defalcation may include actions of negligence or simple mistake, such as "'failure to fully account for money received in trust'". *Id.* at 271-72.

This Court ultimately held, however, that the definition of defalcation for purposes of denying a debtor's discharge pursuant to Section 523(a)(4) requires a party objecting to the debtor's discharge to demonstrate that the debtor's conduct involved: (i)

bad faith, moral turpitude, or other immoral conduct; (ii) an intentional wrong. This Court continued to state that intentional misconduct includes "not only conduct the fiduciary knows is improper but also reckless conduct of the kind that criminal law treats as the equivalent" of such willful blindness. *Id.* at 273. This Court further stated that its decision was consistent with its decision in *Neal*, which required a creditor objecting to a debtor's discharge on the basis of fraud under the 1867 Act, to demonstrate that the debtor committed intentional fraud and not constructive or implied fraud. *Id.* at 274.

Moreover, in *Bullock*, this Court noted: "[T]his interpretation is consistent with the long-standing principle that "exceptions to discharge 'should be confined to those *expressly expressed*.'" *Id.* at 275-76 (emphasis added) (citations omitted). This Court continued:

> [This interpretation] is also consistent with a set of statutory exceptions that Congress normally confines to circumstances where strong, special public policy considerations, such as the presence of fault, argue for preserving the debt, thereby benefitting, for example a typically more honest creditor. . . . In the absence of fault, it is difficult to find strong policy reasons favoring a broader exception here, at least in respect to those whom a scienter

> requirement will most likely help, namely *nonprofessional* trustees, perhaps administering small family trusts. . . . *Id.* at 275-76 (emphasis in original).

Similarly, in 1998, this Court construed the exception to discharge contained in Section 523(a)(6), which provides that a debt "for willful and malicious injury . . . to another" is nondischargeable. 11 U.S.C. § 523(a)(6); *Kawaauhau*, 523 U.S. at 57. In *Kawaauhau*, Geiger, a doctor, committed medical malpractice by mistreating Mrs. Kawaauhau who sought treatment for an injured foot. *Id.* at 59. Dr. Geiger initially prescribed her oral penicillin, which was less effective (and less expensive) than intravenous penicillin. *Id.* Later, Dr. Geiger discontinued all antibiotics because he mistakenly believed that the infection had abated. *Id.* Mrs. Kawaauhau's condition, however, became worse, and she later had to have a part of her leg amputated as a result of Dr. Geiger's malpractice. *Id.* Mrs. Kawaauhau and her husband obtained a judgment against Dr. Geiger in state court. *Id.* Dr. Geiger, who did not have malpractice insurance, then filed for bankruptcy seeking to discharge, *inter alia*, the debt arising from the medical malpractice judgment. *Id.* at 60.

The Kawaauhaus filed an adversary proceeding in the bankruptcy court objecting to Dr. Geiger's discharge. *Id.* The bankruptcy court held that Dr. Geiger's debt was nondischargeable under Section

523(a)(6) based on "willful and malicious injury". *Id.* The case eventually made its way to the Eighth Circuit, which reversed the bankruptcy court. *Id.* This Court granted certiorari and affirmed the decision of the Eighth Circuit. In holding that Section 523(a)(6) did not prevent Dr. Geiger from obtaining a discharge, this Court stated the exception from discharge contained in Section 523(a)(6) does not apply to debts arising from intentional acts that are not intended to cause injury, such as debts arising from medical malpractice. *Id.* at 61-62. Instead, Section 523(a)(6) applies to debts arising from "acts done with the actual intent to cause injury." *Id.* This Court continued to reason:

> Had Congress meant to exempt debts resulting from unintentionally inflicted injuries, it might have described instead 'willful acts that cause injury.'
>
> Or, Congress might have selected an additional word or words, i.e., 'reckless' or 'negligent,' to modify 'injury.' Moreover, as the Eighth Circuit observed, the (a)(6) formulation triggers in the lawyer's mind the category 'intentional torts,' as distinguished from negligent or reckless torts. Intentional torts generally require that the actor intend 'the consequences of an act,' not simply 'the act itself.'

Id. at 62-23 (citations omitted). This Court noted that interpreting the exception to discharge contained in Section 523(a)(6) more broadly would violate the fundamental principle that exceptions to discharge "should be confined to those plainly expressed [in the Code]." *Id.* at 62 (citations omitted).

This Court's holdings and analysis in *Bullock* and *Kawaauhau* strongly militate against prohibiting an innocent debtor from obtaining a discharge under Section 523(a)(2)(A) for a debt based on fraud imputed to the debtor from an agent or a partner, without some demonstration of culpability by the debtor—i.e. the debtor's knowledge or inquiry notice of the fraud. Indeed, *Bullock* and *Kawaauhau* did involve some level of misconduct by the debtors in those cases. In *Bullock*, the debtor, took loans from a trust with respect to which he was a fiduciary (the trustee of the trust) and invested the loan in a business opportunity that he did not intend to share with the trust. *Bullock*, 569 U.S. at 270. Likewise, in *Kawaauhau*, Dr. Geiger, who did not carry medical malpractice insurance, knowingly administered a less effective medical treatment to a patient who had a serious infection in her foot, and prematurely cancelled that treatment, resulting in the necessity of amputating not only the patient's foot, but also amputating a portion of her leg. *Kawaauhau*, 523 U.S. at 59.

In this case, by contrast, Mrs. Bartenwerfer did not commit any misconduct whatsoever—she merely had the misfortune of unknowingly dealing with a fraudster. Therefore, as this Court held that Sections 523(a)(4) and (a)(6) did not prevent the debtors in

Bullock and *Kawaauhau*, respectively, from obtaining a discharge, it should hold that in this case, Section 523(a)(2)(A) does not prevent Mrs. Bartenwerfer from obtaining a discharge.

Moreover, the Ninth Circuit ignored this Court's statement in *Bullock* regarding the confinement of the exceptions to discharge to those "expressly expressed." *Bullock*, 569 U.S. at 275-76. The Ninth Circuit, in its opinion, essentially expanded the scope of the exception to discharge contained in Section 523(a)(2)(A) by holding that Section 523(a)(2)(A) prevented Mrs. Bartenwerfer from obtaining a discharge for a debt arising from her husband's fraud, even though she neither knew nor should have known of his fraud. This broad interpretation of Section 523(a)(2)(A) is not supported by the text of the statute or by this Court's decisions.

IV. THE NINTH CIRCUIT'S DECISION LEADS TO ESPECIALLY ABSURD RESULTS INCONSISTENT WITH THE UNDERLYING POLICY OF THE CODE WHEN APPLIED TO MARRIED COUPLES AND DOMESTIC PARTNERSHIPS

The Ninth Circuit's decision is problematic in the context of married couples or couples in domestic partnerships. Although marriage or entry into a domestic partnership by itself may not legally create a partnership or agency relationship, "many of the typical activities married couples [or domestic partners], such as the sale of jointly-owned property"

could, depending on the facts, establish a partnership or agency relationship. Resnicoff, *supra*, at *178*-80.

Marriages and domestic partnerships involve psychological, emotional and "social dynamics . . . . far more complex" than routine business relationships. *Id*. at 179. Indeed, "many debtors [in marriages or domestic partnerships] may have no meaningful way to control their respective spouses [or domestic partners]. *Id*. This is especially true in marriages or domestic partnerships that involve an abusive spouse or an abusive domestic partner. In such situations, the possibility of a spouse's or domestic partner's inability to obtain a discharge would not likely "motivate a passive spouse [or passive domestic partner], unsuspecting of the family's financial demise and unwilling to incur [his or] her spouse's [or domestic partner's] wrath, to . . . . actively" monitor the financial condition of the passive spouse's (or passive domestic partner's) family. *Id*.

Moreover, financial abuse is a feature of domestic violence. Angela Littwin, *Coerced Debt: The Role of Consumer Credit in Domestic Violence*, 100 CALIF. L. REV. 951, 953 (2012). Abusive spouses or domestic partners who engage in financial abuse, *inter alia*, may coerce or heavily influence the victimized spouse or domestic partner to sign financial documents without asking the abusive spouse or partner any questions regarding the document(s) being signed. *Id*. at 988-90. The Ninth Circuit's holding could lead to draconian results in marriages or domestic partnerships that involve an abusive or oppressive spouse or domestic partner.

For example, if hypothetically in this case, one of the debtor spouses was a victim of financial abuse (the "Abused Spouse"), the Ninth Circuit's decision would deprive the Abused Spouse of a discharge if the Abused Spouse: (i) was a victim of financial abuse justifiably afraid to ask his or her spouse (the ("Abusive Spouse")) "too many questions" about the forms the Abused Spouse was signing; (ii) was coerced into signing a document related to the sale of a home with respect to which the Abusive Spouse made a fraudulent misrepresentation upon which the Buyer justifiably relied; and (iii) at all times relevant, never knew nor should have known of the Abusive Spouse's fraudulent conduct vis-à-vis the Buyer. Applying the Ninth Circuit's holding in such a situation "would simply punish an innocent spouse for failing to take heroic steps to change the intra-family power structure." Resnicoff, *supra*, at 180.

This dismal situation for such an innocent and victimized spouse or domestic partner would be worse if he or she also had children to support. In such a situation, the innocent spouse or domestic partner, and, indirectly, his or her children, would suffer under the scourge of a life-long nondischargeable debt. Tragically for the innocent spouse (or domestic partner) and his or her children, that nondischargeable debt would have arisen solely from a relationship in which an abusive spouse or abusive domestic partner committed fraudulent conduct, with respect to which the innocent and honest spouse (or domestic partner): (i) neither knew nor should have known; and (ii) was powerless to control. Innocent

spouses and domestic partners in such a situation are the very "honest but unfortunate debtors" the bedrock principles underlying the Code are meant to protect by discharging them from burdensome debts and giving them a "fresh start". This Court, therefore, should reverse the Ninth Circuit's decision.

CONCLUSION

The decision of the U.S. Court of Appeals for the Ninth Circuit should be reversed.

Respectfully submitted,

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APPENDIX

APPENDIX

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