

# PUBLICATION

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## The Case of Actually Actual Fraud

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**On May 16, the bankruptcy world of "actual fraud" got larger. In an opinion delivered by Justice Sotomayor, the Supreme Court addressed what it recognized was a deepening circuit split regarding the interpretation of "actual fraud" in 11 U.S.C. § 523(a)(2)(A). After analyzing the history and structure of the code section, the Court rejected a narrower interpretation of the statute requiring that the debt be procured by a false representation at the time of inducement and clarified that "actual fraud" included traditional forms of fraud, such as a fraudulent transfer or similar wrongdoing.**

In the case of *Husky International Electronics, Inc., v. Ritz*, a third-party borrower was drained of assets by its director and co-owner, Ritz, after incurring a debt to Husky. It was undisputed that Ritz transferred these assets to other entities he controlled. After piercing the corporate veil, Husky initiated legal proceedings against Ritz for fraud, and Ritz filed for chapter 7 bankruptcy. Husky responded by seeking to have the debt deemed nondischargeable under § 523(a)(2)(A). The District Court found that Ritz not obtain the debt by actual fraud, and that Husky's debt was dischargeable. Husky appealed the decision, and the Fifth Circuit affirmed the District Court's ruling, disagreeing that Ritz's conveyance scheme constituted "actual fraud" under § 523(a)(2)(A), because Ritz did not make misrepresentations to Husky about the assets or subsequent transfers to induce Husky's actions.

After granting certiorari, the Supreme Court held that "actual fraud" in § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation." The Court explained that in amending section § 523(a)(2)(A) in 1978, Congress could not have intended the added term "actual fraud" to be duplicative of the terms "false pretenses or false representations." Additionally, historical evidence supported the finding that "actual fraud" was broader than a mere misrepresentation to induce an action, as the common law origin of fraud has been used to "describe asset transfers that . . . impair a creditor's ability to collect a debt." The Court also noted that their interpretation is not duplicative of § 523(a)(4), (6) or § 727(a)(2), as the Court's interpretation was broader than the conduct named or "meaningfully different" from those code sections. Third, the Court opined that their holding was not inconsistent with § 523(a)(2)(A)'s requirement that the debt be "obtained by" fraud, because "[e]ven though the transferor of a fraudulent conveyance does not obtain assets or debts through the fraudulent conveyance, the transferee – who, with the requisite intent, also commits fraud – does." Finally, the Court noted that "reading the phrase "actual fraud" to restrict, rather than expand, the discharge exception's reach would untenably require reading the disjunctive "or" in the phrase "false pretenses, a false representation, or actual fraud" to mean "by." The Court pointed out that "a false representation has never been a required element of "actual fraud" and that they would decline to adopt such an element, thereby punting the discussion of what objectively constitutes actual fraud, leaving the term open to argument and interpretation by lower courts at creditors' request.

In his dissent, Justice Thomas provided a textual analysis and noted that the "obtained by" language had been taken out of context by the majority who missed the need to narrowly construe objections to discharge. It is unknown the ramifications of this decision. Will this turn § 523(a)(2)(A) into a general discharge provision? Will creditors move to seek nondischargeability of their debts from alter-ego recipients of a borrower's assets? It will be to the task of the lower courts to further shape and provide guidelines to this new interpretation of § 523(a)(2)(A).

