No.

In the Supreme Court of the United States

CARRIE D. LAWSON,

Petitioner,

v.

SAUER INCORPORATED, D/B/A SAUER SOUTHEAST,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Bankruptcy Code excepts certain debts from discharge. Relevant here, 11 U.S.C. § 523(a)(2)(A) renders a debt "obtained by * * * false pretenses, a false representation, or actual fraud" non-dischargeable. Reasoning that "actual fraud" requires a misrepresentation, the Fifth Circuit holds that Section 523(a)(2)(A) does not apply to a debt stemming from a fraudulent transfer, in the absence of a misrepresentation. The First and Seventh Circuits disagree. The question presented is:

Whether Section 523(a)(2)(A) renders non-dischargeable a claim against a debtor based on a fraudulent transfer, in circumstances where the debtor did not make a misrepresentation.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Carrie D. Lawson respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-23a) will be reported at __ F.3d __, 2015 WL 3982395. The order of the bankruptcy appellate panel is unreported. App., *infra*, 24a-33a. The bankruptcy court's opinion (*id.* at 34a-50a) is reported at 505 B.R. 117.

JURISDICTION

The judgment of the court of appeals was entered on July 1, 2015. App., *infra*, 1a. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Title 11, U.S. Code § 523 provides in pertinent part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) 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 ***.
>
> * * *

> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

STATEMENT

This petition presents a significant and recurring question that has divided the courts of appeals: whether a creditor, who seeks to exempt a debt from discharge as "actual fraud" within the meaning of Section 523(a)(2)(A), must demonstrate that the debtor made a misrepresentation. Here, in the context of a debt for a fraudulent transfer, it is undisputed that petitioner (the debtor) made no misrepresentation. On this basis, the bankruptcy court dismissed efforts by the respondent (the creditor) to render petitioner's debt non-dischargeable. But the court of appeals reversed. Expressly adopting the holding of the Seventh Circuit, and recognizing a conflict with the Fifth Circuit, the court of appeals held that "actual fraud," as used in Section 523(a)(2)(A), does not require a misrepresentation.

The Court should grant certiorari to resolve this acknowledged division among the circuits. As this case shows, the issue is often determinative of whether certain debts may be discharged in bankruptcy. The question presented also arises with great frequency, both in the specific context of fraudulent transfers and in myriad other factual settings. And the decision below is wrong: it departs from the common-law meaning of "actual fraud," it is inconsistent with this Court's previous construction of Section 523(a)(2)(A), and it undermines the careful statutory structure Congress crafted. This Court's intervention is warranted.

A. Statutory Background.

A bankruptcy proceeding discharges debts held by an individual (see, *e.g.*, 11 U.S.C. §§ 727, 1328), providing "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Brown* v. *Felson*, 442 U.S. 127, 128 (1979) (quotation omitted).

An individual debtor may typically pursue two forms of bankruptcy. "Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Harris* v. *Viegelahn*, 135 S. Ct. 1829, 1835 (2015). Chapter 13, by contrast, is "[a] wholly voluntary alternative to Chapter 7" that "allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three- to five-year period." *Ibid.* A Chapter 13 bankruptcy "can benefit debtors and creditors alike;" while "[d]ebtors are allowed to retain their assets, commonly their home or car," a creditor will "usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation," because they have access to the "debtor's 'disposable' postpetition income." *Ibid.*

The discharge of debt is subject to several exceptions, including those contained in 11 U.S.C. § 523(a). See *Field* v. *Mans*, 516 U.S. 59, 64 (1995). In particular, Section 523(a)(2)(A) renders a "debt" "obtained by * * * false pretenses, a false representation, or actual fraud" non-dischargeable. Such debts are exempt from discharge in both a Chapter 7 and a Chapter 13 bankruptcy. See 11 U.S.C. §§ 727(b), 1328(a)(2).

Additionally, Section 523(a)(6) applies to a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." Section 523(a)(6) excepts from discharge debts in a Chapter 7 bankruptcy (11 U.S.C. § 727(b)), but it does *not* apply to Chapter 13 bankruptcies (*id.* § 1328(a)(2)). In this way, "[a] discharge under Chapter 13 'is broader than the discharge received in any other chapter.'" *United Student Aid Funds, Inc.* v. *Espinosa*, 559 U.S. 260, 268 (2010). This creates "an incentive for debtors" to use and complete a Chapter 13 reorganization, an outcome beneficial to creditors. 8 Collier on Bankruptcy ¶ 1328.02[2][b].

B. Factual Background.

Respondent sued petitioner's father, James Lawson, and won a state-court judgment against him for $168,351.59. App., *infra*, 3a. Prior to entry of the judgment, James transferred $100,150 to an entity, Commercial Construction M&C, LLC, that respondent asserts petitioner owns. *Id.* at 3a-4a. According to the respondent, petitioner personally received $80,000 in transfers from this entity. *Id.* at 4a.

Pursuant to the Rhode Island Uniform Fraudulent Transfer Act (RIUFTA), respondent sought to execute its judgment against petitioner. App., *infra*, 4a. A state court held that petitioner received fraudulent transfers within the meaning of RIUFTA, and it thus entered judgment against petitioner, in favor of respondent, for $80,000. *Ibid.*

Petitioner filed for Chapter 13 bankruptcy protection. App., *infra*, 4a.

C. Proceedings Below.

1. In the bankruptcy court, respondent initiated this adversary proceeding. Respondent contended that the fraudulent transfer judgment entered by the state court constitutes a debt incurred by "actual fraud" within the meaning of Section 523(a)(2)(A) and is thus non-dischargeable. App., *infra*, 37a-38a. Respondent conceded that it did not, and could not, allege that petitioner made a misrepresentation. *Id.* at 38a. Arguing that Section 523(a)(2) does not apply absent a misrepresentation, petitioner moved to dismiss the proceeding. *Id.* at 38a-39a.

The bankruptcy court granted petitioner's motion. App., *infra*, 34a-50a. Relying on *Field*, the court concluded that "the term 'actual fraud'" in Section 523(a)(2)(A) requires the "elements that the common law already had defined the term to include." *Id.* at 46a. And, following circuit precedent, the court held that "actual fraud" "require[es] a misrepresentation." *Ibid.* Additionally, the court reasoned that, while Section 523(a)(6) reaches some fraudulent transfer judgments, (a)(6) does not apply in a Chapter 13 bankruptcy. *Id.* at 48a-50a. Carefully delineating between the scope of Sections (a)(2)(A) and (a)(6) maintains "the distinction between the broader discharge available under Chapter 13 and the more limited discharge available under Chapter 7." *Id.* at 50a.

2. Respondent appealed to the First Circuit's Bankruptcy Appellate Panel and petitioned for a direct appeal to the First Circuit. App., *infra*, 24a. Finding that the question "involves a matter of public importance" and further that its resolution "will advance 'the cause of jurisprudence,'" the panel certified the case for immediate appeal. *Id.* at 33a (quotations omitted).

3. The court of appeals reversed. The court recognized that the "sole issue on appeal" is the "question of law" as to "whether the bankruptcy court erred in concluding that 'a misrepresentation by a debtor to a creditor is an essential element of establishing a basis for the nondischarge of a debt under [Section] 523(a)(2)(A).'" App., *infra*, 5a.

The court reasoned that the "common law understanding" of "actual fraud," as it existed in 1978 when Congress adopted Section 523(a)(2)(A), was "not limited to fraud effected by misrepresentation." App., *infra*, 10a. It also found that a broader definition is necessary to distinguish "actual fraud" from Section 523(a)(2)(A)'s separate inclusion of "false representation." *Id.* at 11a-12a. And, in the lower court's view, the legislative history supports an expansive understanding of "actual fraud." *Id.* at 12a-15a. The court thus concluded that a debt "'obtained by . . . actual fraud' extends beyond debts incurred through fraudulent misrepresentations to also include debts incurred as a result of knowingly accepting a fraudulent conveyance that the transferee knew was intended to hinder the transferor's creditors." *Id.* at 2a.

REASONS FOR GRANTING THE PETITION

The Court should grant certiorari to resolve the clear conflict among the circuits regarding whether a misrepresentation is a necessary element to exempt a debt from discharge pursuant to Section 523-(a)(2)(A). The Fifth Circuit, in *In re Ritz*, 787 F.3d 312 (5th Cir. 2015), held that a misrepresentation is required. The Seventh Circuit, in *McClellan* v. *Cantrell*, 217 F.3d 890 (7th Cir. 2000), and the First Circuit, in this case, disagree.

The issue is a matter of considerable importance. When it arises, the legal rule is usually, as it is here, determinative as to whether a creditor may seek to exempt certain debts from discharge. And given that nearly a million bankruptcy petitions are filed each year, it is no surprise that this question arises with frequency.

The decision below is also plainly wrong. A misrepresentation is the defining element of common law fraud; in the absence of a misrepresentation, conduct may well be wrongful, but it is not fraud. The lower court, moreover, failed to appreciate the significance of *Field* to the issue posed here. And, by expansively interpreting the scope of Section 523(a)(2)(A), the holding below disrupts the careful incentives Congress crafted to encourage debtors to pursue Chapter 13, rather than Chapter 7, bankruptcies.

This case is an ideal vehicle to resolve this "question of law," which, as the lower court acknowledged, was the "sole issue on appeal." App., *infra*, 5a. Typically, beyond disputing whether a misrepresentation is required, parties also contest whether the particular facts of a case constitute a misrepresentation. Not so here—respondent "concededly could not allege that [petitioner] had made a misrepresentation." *Ibid*. If, as the Fifth Circuit holds, a misrepresentation is a necessary element of "actual fraud," respondent's adversary proceeding must be dismissed. *Id*. at 34a-50a.

A. There Is An Acknowledged Conflict Among The Courts Of Appeals Over The Question Presented.

The courts of appeals openly acknowledge their disagreement as to the question presented. Below, in holding that Section 523(a)(2)(A) does apply to fraudulent conveyance claims against a debtor absent a misrepresentation, the First Circuit recognized that the Fifth Circuit, in *Ritz*, "has disagreed" with the Seventh Circuit "and our analysis here." App., *infra*, 2a n.1. The Fifth Circuit, for its part, expressly "decline[d]" to "adopt[] the interpretation of Section 523(a)(2)(A) endorsed by" the Seventh Circuit. *In re Ritz*, 787 F.3d at 317.

1. In *McClellan*, 217 F.3d at 892, the **Seventh Circuit** held that "[n]o learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions." Rather, all that matters, according to the Seventh Circuit, is a demonstration of the debtor's "intent to defraud," regardless whether this "was implemented by a misrepresentation or by some other improper means." *Id*. at 894. The court thus found that Section 523(a)(A)(2) excepts from discharge a claim for fraudulent transfer, even absent a misrepresentation. *Id*. at 892.[1]

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[1] Judge Ripple concluded that a fraudulent conveyance, absent a misrepresentation, better fits within Section 523(a)(6)'s exception to discharge. See *McClellan*, 217 F.3d at 896. As we explain below, *infra* 19-20, this conclusion is correct: Section 523(a)(6)—not Section 523(a)(2)(A)—supplies the proper framework to determine whether such debts are exempt from discharge.

Here, the **First Circuit** expressly "join[ed] the Seventh Circuit in concluding" that Section 523-(a)(2)(A) "extends beyond debts incurred through fraudulent misrepresentations to also include debts incurred as a result of knowingly accepting a fraudulent conveyance." App., *infra*, 2a. Thus, the court "h[e]ld that 'actual fraud' under [Section] 523-(a)(2)(A) is not limited to fraud effected by misrepresentation." *Id*. at 10a. Adopting the Seventh Circuit's view, the court concluded that "actual fraud" includes all acts by a debtor "intended to hinder the relevant creditors." *Ibid*. (quotation & alteration omitted).

2. The **Fifth Circuit** has reached the opposite conclusion. *In re Ritz*, 787 F.3d at 316. Expressly "declin[ing]" to adopt the Seventh Circuit's holding in *McClellan*, the court held that "actual fraud," as used in Section 523(a)(2)(A), "cannot" be established where "the debtor made no false representation to the creditor." *Ibid*. In the Fifth Circuit's view, the common law concept of fraud requires "a representation." *Id*. at 318-319. And the court further concluded that the statute's history, its interaction with separate provisions of the Bankruptcy Code, and this Court's decision in *Field* all confirm the conclusion that "a representation is a necessary prerequisite for a showing of 'actual fraud' under Section 523-(a)(2)(A)." *Id*. at 321. The court thus concluded that a fraudulent transfer debt, absent a misrepresentation, is outside the scope of Section 523(a)(2)(A). *Ibid*.

B. The Question Presented Is Important.

The court of appeals recognized that the question presented is "narrow but significant." App., *infra*, 2a. That observation is undoubtedly correct. As this case illustrates, the question presented is often disposi-

tive as to whether certain debts are discharged in bankruptcy—an issue of substantial practical importance to debtors and creditors alike.

This Court's review is warranted because the issue recurs with considerable frequency. Answering this question will also resolve, more broadly, whether a misrepresentation is an essential element to Section 523(a)(2)(A)'s exception to discharge for "actual fraud"—an issue that arises in various factual circumstances apart from fraudulent conveyance claims. Finally, uniformity concerns are especially acute in the bankruptcy context.

1. The frequency with which the question presented is litigated demonstrates its significance. Not only has the issue arisen in the First,[2] Fifth,[3] and Seventh[4] Circuits, but it likewise consistently appears in the Second,[5] Third,[6] Fourth,[7] Sixth,[8] Ninth,[9]

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[2] See, *e.g.*, *In re Woodford*, 403 B.R. 177, 187 (Bankr. D. Mass. 2009) (misrepresentation required).

[3] See, *e.g.*, *In re Lewis,* 2010 WL 1379770, at *3 (Bankr. E.D. Tex. 2010) (misrepresentation required).

[4] See, *e.g.*, *In re Bozorgzadeh*, 2012 WL 2803741, at *6 (Bankr. S.D. Ill. 2012) (following *McClellan*); *In re Schuadt*, 2012 WL 909299, at *15 (Bankr. N.D. Ill. 2012) (same); *In re Vogel*, 2005 WL 3506443, at *6 (Bankr. C.D. Ill. 2005) (same).

[5] Compare *In re Wheeler*, 511 B.R. 240, 248 (Bankr. N.D.N.Y. 2014) (representation required); *In re Halperin*, 215 B.R. 321, 336 (Bankr. E.D.N.Y. 1997) (same) with *In re Kuncman*, 454 B.R. 276, 284 (Bankr. E.D.N.Y. 2011) (misrepresentation not required).

[6] Compare *In re Suarez*, 2010 WL 1382110, at *16 (Bankr. D.N.J. 2010) (misrepresentation required); *In re Carter*, 236 B.R. 173, 182 (Bankr. E.D. Pa. 1999) (same, in *dicta*); *In re Haining*, 119 B.R. 460, 463 (D. Del. 1990) (same) with *In re*

and Tenth[10] Circuits, with substantially conflicting results. Given the enormous number of bankruptcy proceedings—911,086 cases were commenced in the year ending March 31, 2015, and 1,038,280 cases the year prior (see U.S. Courts Statistics & Reports, Table F, Bankruptcy Filings (Mar. 31, 2015))—the issue will continue to divide the lower courts.

2. Resolution of the question presented, moreover, has substantial importance outside the specific context of fraudulent transfer. Following *McClellan*'s holding that Section 523(a)(2)(A)'s exemption for "actual fraud" does not require a misrepresentation, creditors have attempted to use this provision when-

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Kiesewetter, 391 B.R. 740, 748 (Bankr. W.D. Penn. 2008); (misrepresentation not required); *In re Draughon*, 2007 WL 7645346, at *8-9 (Bankr. W.D. Penn. 2007) (same); *In re Barber*, 281 B.R. 617, 624 (Bankr. W.D. Penn. 2002) (same).

[7] See, *e.g.*, *In re McKnew*, 270 B.R. 593, 618 (Bankr. E.D. Va. 2001) (misrepresentation required in analogous circumstances). See also *In re Gonsalves*, 519 B.R. 466, 473 (Bankr. D. Md. 2014) ("The court has misgivings whether the broader application of § 523(a)(2)(A) stated in *McClellan* is available in the Fourth Circuit.").

[8] Compare *In re Kalinowski*, 2012 WL 4736798, at *2 (Bankr. E.D. Mich. 2012) (misrepresentation required) with *In re Smith*, 407 B.R. 442 (BAP 6th Cir. 2008) (misrepresentation not required); *In re Vitanovich*, 259 B.R. 873 (B.A.P. 6th Cir. 2001) (same); *In re Perry*, 448 B.R. 219, 225 (Bankr. N.D. Ohio 2011) (same).

[9] See, *e.g.*, *In re Kimmel*, 2006 WL 6810976, at *8 (BAP 9th Cir. 2006) (expressing disapproval of *McClellan*); *Lim* v. *Brown*, 2012 WL 1496205, at *4 (N.D. Cal. 2012) (recognizing disapproval of *McClellan* in *Rooz*); *In re Sharma*, 2015 WL 3825887, at *5 (Bankr. N.D. Cal. 2015) (misrepresentation required).

[10] See, *e.g.*, *In re Vickery*, 486 B.R. 680, 691 (BAP 10th Cir. 2013) (misrepresentation not required).

ever a debtor may be said to have intentionally hindered the creditor's rights. For example, the issue arises in these frequently recurring circumstances:

- Disputes among business partners. See, *e.g.*, *In re Alwood*, 531 B.R. 182, 187 (Bankr. N.D. Ohio 2015); *In re Rashid*, 2014 WL 4922478, at *1 (N.D. Ill. 2014); *In re Sorbera*, 483 B.R. 580, 582 (Bankr. D. Mass. 2012); *In re Bledsoe*, 2010 WL 2179721, at *2 (Bankr. C.D. Ill. 2010).
- Claims relating to stolen property or misappropriated assets. See, *e.g.*, *In re Epstein*, 2011 WL 672241, at *7 (Bankr. D.N.J. 2011); *In re Luedtke*, 429 B.R. 241 (Bankr. N.D. Ind. 2010); *In re Broholm*, 310 B.R. 864, 875 (Bankr. N.D. Ill. 2004).
- Claims for use of checks or credit cards without sufficient funds. See, *e.g.*, *In re Indzheyan*, 2012 WL 6212698, at *6 (Bankr. C.D. Cal. 2012); *In re Kendrick*, 314 B.R. 468, 472 (Bankr. N.D. Ga. 2004); *In re Brobsten*, 2001 WL 34076352, at *4 (Bankr. C.D. Ill. 2001) ("The general fraud analysis described in *McClellan* is particularly benefitting to credit card users.").

If, as the First and Seventh Circuits have held, Section 523(a)(2)(A) does not require a misrepresentation, the factual circumstances in which that exception to discharge applies expand dramatically.

3. While all federal statutes should be interpreted uniformly across the Nation, special considerations apply in the context of the Bankruptcy Code. The Constitution requires "uniform Laws on the subject of Bankruptcies throughout the United States."

U.S. Const. Art. I, § 8. This reflects a "general agreement" by the Founding Fathers "on the importance of authorizing a uniform federal response" to bankruptcy. *Cent. Va. Cmty. Coll.* v. *Katz*, 546 U.S. 356, 369 (2006). As Justice Frankfurter explained, "[t]he Constitutional requirement of uniformity is a requirement of *geographic* uniformity." *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 172 (1946) (Frankfurter, J., concurring) (emphasis added). Thus, debtors must be "treated alike by the bankruptcy administration throughout the country regardless of the State in which the bankruptcy court sits." *Ibid*.

There is a practical need for uniformity: a debtor has broad discretion in choosing venue. Individual debtors may file a petition for bankruptcy in any venue in which, for the past 180 days, they have maintained a domicile, a residence, a principal place of business, or their principal assets. 28 U.S.C. § 1408(1). As a result, debtors may have multiple venues in which they can seek bankruptcy protection. And wily debtors, with 180 days' foresight, may manufacture venue by moving either their assets or residence. Differences in venue should not yield differences in result; whatever the answer to the question presented, it should be same throughout the Nation.

C. The Court Below Erred.

While an acknowledged circuit split on an important question of statutory interpretation is sufficient reason to grant review, that need is heightened here because the decision below is wrong. It departs from the well-understood meaning of "actual fraud" that exists at common law, it disregards this Court's

decision in *Field*, and it makes a hash of the delicate statutory structure.

1. The statutory text compels the conclusion that, for a debt to qualify as non-dischargeable pursuant to Section 523(a)(2)(A), the debtor must have made a misrepresentation. This Court has already held that the term "actual fraud" in Section 523-(a)(2)(A) adopts the common law elements of fraud. And, at common law, a misrepresentation is the defining element of the tort.[11]

In *Field*, the Court considered whether "actual fraud," as used in Section 523(a)(2)(A) requires, "reasonable reliance," or the less demanding standard of "justifiable reliance." 516 U.S. at 61. (The Court held justifiable reliance sufficient.)

To answer that question, *Field* applied the "well established" canon that, "where Congress uses terms that have accumulated settled meaning under the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Field*, 516 U.S. at 69. The Court concluded that, in Section 523(a)(2)(A), "there is no reason to doubt Congress's intent to adopt a common-law understanding." *Id.* at 70. Thus, "actual fraud" "impl[ies] elements that the common law has defined." 516 U.S. at 69.

The common law is clear: a misrepresentation is a necessary element of "actual fraud." *Field* considered the Restatement (Second) of Torts (1976), which

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[11] In this context, a "[m]isrepresentation" means "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth." Restatement (Second) Torts § 525 cmt. b.

was the "most widely accepted distillation of the common law of torts" in 1978 when Congress introduced the term "actual fraud." See *Field*, 516 U.S. at 70. Specifically, the Court looked to Restatement Sections 537 and 540; under these provisions, a misrepresentation is a necessary element. Likewise, the Restatement's general definition of "fraudulent misrepresentation" necessarily requires a "misrepresentation." Restatement § 525.[12]

The Second Restatement is no outlier. As this Court has routinely acknowledged, "the well-settled meaning of 'fraud' require[s] a misrepresentation or concealment of *material* fact." *Neder* v. *United States*, 527 U.S. 1, 22 (1999). See also *BMW of N. Am., Inc.* v. *Gore*, 517 U.S. 559, 579 (1996) ("actionable fraud requires a *material* misrepresentation or omission"); William J. Prosser, Law of Torts § 106 (4th ed. 1971) ("The representation which will serve as a basis for an action of deceit, as well as other forms of relief, usually consists, of course, of oral or written words; but it is not necessarily so limited.").

The lower court (App., *infra*, 9a) and the Seventh Circuit (*McClellan*, 217 F.3d at 893) note that Collier defines the term fraud broadly to mean "any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another." 4 *Collier on Bankruptcy* ¶ 523.08[1][e]. But Collier holds, plainly, that a misrepresentation is necessary: "To sustain a prima facie case of fraud, a

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[12] While the Second Restatement contains no general definition of "fraud," the draft Third Restatement does. It models Section 525 of the Second Restatement, requiring a misrepresentation as a necessary element. Restatement (Third) of Torts: Liab. for Econ. Harm § 9 Tentative Draft No. 2 (2014).

plaintiff under section 523(a)(2) must establish * * * that the debtor made the representation." *Ibid*.

Neither the Seventh Circuit nor the court below offer a valid basis to conclude otherwise. To support its statement that "[n]o learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions," the Seventh Circuit identifies a single, cherry-picked decision from Oklahoma, *Stapleton* v. *Holt*, 250 P.2d 451, 453-454 (Okla. 1952). See *McClellan*, 217 F.3d at 893; App., *infra*, 9a-10a. But *Stapleton* holds, in the plainest of terms, that fraud requires either "false suggestions" or "the suppression of truth," which is to say, a misrepresentation. 250 P.2d at 453-454. The opinion even turned on the court's finding that the evidence there "was sufficient to authorize the jury in finding" that "the alleged representation made was false." *Id*. at 454.

Here, the court of appeals relied on Section 871 of the Second Restatement. App., *infra*, 9a. But Section 871 strongly *supports* the conclusion that a fraudulent transfer, absent a misrepresentation, does not qualify as common law fraud.

Section 871 (titled "Intentional Harm to a Property Interest") is located within the "Miscellaneous Rules" division of the Restatement, not the "Misrepresentation" division, where the rules regarding fraud reside. This is for a reason: intentional harm to a property interest is not, in all cases, a species of fraud. Comment e to Section 871, titled "fraud," instructs that "[t]he actor's conduct is fraudulent *if* he intentionally causes another to act or refrain from acting *by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has*

a duty to reveal to the other." *Id.* § 871 cmt. e (emphasis added). And, the Restatement directs, "[f]or a statement of what constitutes fraudulent misrepresentation and nondisclosure in business transactions, see §§ 526-530 and 550-551." *Ibid.*[13]

Intentionally harming another's property interest is fraud if, and only if, it is accompanied by the hallmark of fraudulent conduct—a misrepresentation.[14] Absent a misrepresentation, the conduct may well be a tort. Indeed, it may be a tort that is often non-dischargeable in bankruptcy. See *infra*, 19-20. But it is not common-law fraud.[15]

2. The decision below is also irreconcilable with *Field*. See *Ritz*, 787 F.3d at 318. There, the Court addressed "the concept of 'actual fraud' as it was understood in 1978." 516 U.S. at 70. The Court focused intently on the requirement of a misrepresentation,

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[13] There is no dispute, accordingly, that when a fraudulent transfer satisfies all elements of common law fraud—including a misrepresentation and reliance—that Section 523(a)(2)(A) applies. See, *e.g.*, *In re Wheeler*, 511 B.R. 240, 248 (Bankr. N.D.N.Y. 2014); *In re Kovler*, 249 B.R. 238, 261 (Bankr. S.D.N.Y. 2000).

[14] The lower court pointed to comment a, where the Restatement explains that the rule prohibiting intentional harm to another's property "applies when title to land has been obtained by fraud" and then subsequently transferred. Restatement § 871 cmt. a. But this does not support the decision below. That a Section 871 violation can *result* from fraud does not mean that all Section 871 violations *are* fraud.

[15] Additionally, "[t]he language 'obtained by' clearly indicates that the fraudulent conduct occurred at the inception of the debt, i.e., the debtor committed a fraudulent act to induce the creditor to part with his money or property." *McClellan*, 217 F.3d at 896 (Ripple, J., concurring).

explaining that, "[i]f Congress really had wished to bar discharge to a debtor who made unintentional and wholly immaterial misrepresentations having no effect on a creditor's decision, it could have provided that." 516 U.S. at 68. The opinion turned on the centrality of a misrepresentation to "actual fraud."

The separate opinions in *Field* evince unanimity on the point. Justice Ginsburg, in concurrence, quoted approvingly an exchange during oral argument, where counsel "agree[d]" with the proposition that, if the debtor had "simply transferred the property without saying one word to the creditor," the debt would have been dischargeable. *Field*, 516 U.S. at 79. And Justice Breyer, in dissent, "agree[d] with the Court's holding that 'actual fraud' under 11 U.S.C. § 523(a)(2)(A) incorporates the common-law elements of intentional misrepresentation."

The decision below is inconsistent with *Field* in a more fundamental way. If, as the court of appeals here concluded, a debtor's knowing conduct "intended to hinder the relevant creditors" qualifies as "actual fraud" (App., *infra*, 10a), then the debtor in *Field* would have fallen within the ambit of Section 523(a)(2)(A) *without* any need to evaluate whether he made a misrepresentation, much less whether the creditor relied on it. In *Field*, there was little doubt that the debtor knowingly impeded the property interests of his creditors; he sent them a letter requesting waiver of their rights, while purposefully omitting information that would have triggered a claim against him. *Field*, 516 U.S. at 62. If the court of appeals is correct that intent is all that matters—and no misrepresentation, much less reliance on a misrepresentation, is necessary—this Court's decision was in vain.

3. The decision below also offends the broader statutory structure. Fraudulent transfers fit within a different exception to discharge, Section 523(a)(6). This distinction has substantial practical import: while (a)(2)(A) applies to both Chapter 7 and Chapter 13 bankruptcies, (a)(6) does not apply to Chapter 13. See *supra*, 3-4.

Section 523(a)(6) exempts from discharge debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." As the Court has settled, it covers "a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury." *Kawaauhau* v. *Geiger*, 523 U.S. 57, 61 (1998).

There is broad agreement that (a)(6) provides, in appropriate factual circumstances, a means to exempt from discharge a fraudulent transfer debt. In *In re Bammer*, 131 F.3d 788, 790-793 (9th Cir. 1997), the *en banc* Ninth Circuit held that receipt of a fraudulent transfer, coupled with knowledge that it would hinder the creditor's rights, fits within (a)(6). The Fifth, Eleventh, and even the Seventh Circuit all agree. See *In re Ritz*, 787 F.3d at 322; *In re Kane*, 755 F.3d 1285, 1296 (11th Cir. 2014); *In re Jennings*, 670 F.3d 1329, 1334 (11th Cir. 2012); *McClellan* 217 F.3d at 896 (majority recognizing possibility of (a)(6); Judge Ripple, concurring, advocating use of (a)(6)).

Those decisions are plainly correct. Here, the lower court was wrong to doubt the applicability of (a)(6) to fraudulent transfer debts. Pet. App. 15a-19a. As an initial matter, it said nothing about the "starting point in every case involving construction of a statute"—"the language itself." *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 685 (1985). The court instead looked to the statute's history: reasoning that

because the predecessor to what is now (a)(2)(A) applied to fraudulent transfers, the court concluded that the current form of (a)(2)(A) must likewise do so. App., *infra*, 17a.[16] That conclusion does not follow for several reasons—principally because the portion of the predecessor statute that arguably applied to fraudulent transfers, which covered "willful and malicious injuries to the * * * property of another," *now* resides in (a)(6). See *id.* at 17a-18a.

In sum, by expanding the scope of Section 523(a)(2)(A) to reach debts that are actually encompassed by Section 523(a)(6), the lower court upset the distinctions Congress has purposefully drawn between Chapter 7 and Chapter 13 bankruptcy.

In support of doing so, the lower court invoked the canon against rendering words superfluous, arguing that the term "actual fraud" in Section 523(a)(2)(A) must mean something different from the neighboring term "fraudulent misrepresentation." App., *infra*, 11a-12a. While these terms may differ in certain ways (see *In re Ritz*, 787 F.3d at 320 n.11), this "canon of construction is not a rigid, inviolable dictate." *Id.* at 320. Indeed, "[t]he commentary in *Collier on Bankruptcy* suggests that the addition of 'actual fraud' simply clarifies the limited scope of the fraud exception;" the term "actual fraud" "'probably

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[16] The court observed that, prior to 1970, Section 17(a)(2) (what is now, in amended form, (a)(2)(A)) barred discharge of debts incurred by "willful and malicious injuries to the person or property of another." App., *infra*, 17a. In 1970, Congress amended it to apply to "willful and malicious conversion of the property of another." *Ibid.* Finally, in 1978, Congress eliminated the "willful and malicious" language wholesale from (a)(2)(A) and established (a)(6) in its present form. *Ibid.*

makes no change in the law.'" *Recoveredge, L.P.* v. *Pentecost*, 44 F.3d 1284, 1292 n.16 (5th Cir. 1995) (quoting 3 Collier on Bankruptcy ¶ 523.08[5]).

Ultimately, the lower court's fear of rendering "fraudulent misrepresentation" and "actual fraud" synonymous does not warrant upsetting the balance Congress struck between the scope of discharge available in Chapter 7 and Chapter 13. And it is certainly no reason to define the term "actual fraud" in a way wholly inconsistent with its common law meaning.

4. Finally, to the extent that there is any ambiguity as to the reach of Section 523(a)(2)(A), "exceptions to the operation of a discharge" in bankruptcy "should be confined to those plainly expressed," "[i]n view of the well-known purposes of the bankrupt law." *Gleason* v. *Thaw*, 236 U.S. 558, 562 (1915). See also *Kawaauhau*, 523 U.S. at 62.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 2015

APPENDICES

APPENDIX A

United States Court of Appeals
For the First Circuit

No. 14-2058

IN RE: CARRIE D. LAWSON, Debtor

SAUER INCORPORATED, d/b/a Sauer Southeast,
Appellant,
v.

CARRIE D. LAWSON, Appellee.

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

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

Before

Lynch, Thompson, and Kayatta, Circuit Judges.

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

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

July 1, 2015

LYNCH, Circuit Judge. Sauer Incorporated ("Sauer") filed an adversary proceeding objecting to the discharge of a debt owed by Carrie Lawson ("Ms.

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

On direct appeal, we are asked to resolve this narrow but significant issue of whether a debt that is not dischargeable in Chapter 13 bankruptcy as a debt for money or property "obtained by . . . actual fraud" extends beyond debts incurred through fraudulent misrepresentations to also include debts incurred as a result of knowingly accepting a fraudulent conveyance that the transferee knew was intended to hinder the transferor's creditors. *See* 11 U.S.C. § 523(a)(2)(A). We join the Seventh Circuit in concluding that it does. *See McClellan* v. *Cantrell*, 217 F.3d 890 (7th Cir. 2000).[1]

Having adopted this new standard, we *vacate* and *remand* for further proceedings consistent with

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

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

I.

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

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

Just before the judgment was entered, Ms. Lawson had formed a shell entity, Commercial Construction M&C, LLC ("Commercial Construction").[2] Upon

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

entry of judgment, James transferred $100,150 to Commercial Construction, allegedly to impede Sauer's collection. Commercial Construction is owned by Ms. Lawson, but controlled by James.[3]

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

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

Ms. Lawson filed for Chapter 13 bankruptcy the same month that the Providence Superior Court issued the execution against her, in March 2013. Sauer initiated this adversary proceeding in June 2013, objecting to the discharge of this debt under § 523(a)(2)(A) as being for money "obtained by . . . actual fraud."[4] In particular, Sauer alleged that because Ms. Lawson "knowingly receiv[ed]" the fraudu-

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

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

lent transfer and acted in a "willful and malicious" manner toward Sauer, her acceptance of the fraudulent conveyance constitutes actual, not merely constructive, fraud.[5]

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

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

II.

The sole issue on appeal is whether the bankruptcy court erred in concluding that "a misrepresentation by a debtor to a creditor is an essential element of establishing a basis for the nondischarge of a debt under § 523(a)(2)(A)." *Sauer*, 505 B.R. at 118. This is a question of law, which we review de novo.

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[5] We do not address the adequacy of this pleading under the heightened pleading standard of Rule 9(b), but assume its adequacy for purposes of resolving the appeal. *Cf. N. Am. Catholic Educ.*, 567 F.3d at 16.

See *N. Am. Catholic Educ.*, 567 F.3d at 12; *United States* v. *Nippon Paper Indus. Co.*, 109 F.3d 1, 3 (1st Cir. 1997).

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

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

This case concerns an exemption to Chapter 13 discharge. Although "discharge under Chapter 13 'is broader than the discharge received in any other chapter,'" Chapter 13 still "restricts or prohibits entirely the discharge of certain types of debts." *United Student Aid Funds, Inc.* v. *Espinosa*, 559 U.S. 260, 268 (2010) (quoting 8 *Collier on Bankruptcy* ¶ 1328.01 (rev. 15th ed. 2008)). As relevant here, Chapter 13 does not discharge any debt "for money . . . to the extent obtained by . . . false pretenses, a false representation, or *actual fraud* . . . ." 11 U.S.C. § 523(a)(2)(A) (emphasis added); *id.* § 1328(a)(2) (making § 523(a)(2)(A) expressly applicable to Chapter 13).

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

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[6] This surprising gap has an explanation:

Until 1970, the courts tasked with enforcing a creditor's claim also determined whether the judgment thereby rendered was nondischargeable under the fraud exception. *See Brown*, 442 U.S. at 129-30 (citing Section 17 of the former Bankruptcy Act) ("Typically, that court was a state court."). This proved problematic: creditors were frequently successful in obtaining nondischargeable default judgments in state courts under the exception. *Id.* at 135-36. To avoid creditor abuse, Congress amended the statute to require creditors seeking to bar discharge under the fraud exception to file directly with the bankruptcy court. *See id.* But in the cases since, we did not reach the issue of whether "actual fraud" is limited to fraud effected by misrepresentation because misrepresentation was the only type of fraud charged. *See McClellan*, 217 F.3d at 892-93 (collecting cases); *see, e.g.*, *Field*, 516 U.S. at 70; *Palmacci*, 121 F.3d 781; *see also, e.g.*, *Anastas* v. *Am. Sav. Bank* (*In re Anastas*), 94 F.3d 1280, 1285 (9th Cir. 1996) (finding an "*implied* representation of an intent" to repay a credit card charge (emphasis added)); *Rembert* v. *AT&T Universal Card Servs., Inc.* (*In re Rembert*), 141 F.3d 277, 281 (6th Cir. 1998) (same); *AT&T Universal Card Servs.* v. *Mercer* (*In re Mercer*), 246 F.3d 391, 403 (5th Cir. 2001) (en banc) (noting that implying misrepresentation under the *Palmacci* test is "appropriate for determining card-dischargeability because . . . card-use lends itself to that analysis").

Even so, Ms. Lawson argues -- and the bankruptcy court found -- that our inquiry is foreclosed by controlling Supreme Court and First Circuit precedent in *Field* v. *Mans*, 516 U.S. 59

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

(1995), and *In re Spigel*, 260 F.3d 27 (1st Cir. 2001). But these cases are inapposite.

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

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

That Restatement recognizes several types of "fraud," including both fraudulent misrepresentations and "fraudulent interference with [property rights]," a tort that is broader than misrepresentation itself. *See* Restatement (Second) of Torts, index, "Fraud" (1977); *see also id.* § 871 ("One who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances."). The comments to the relevant Restatement provision, § 871, make clear that this includes fraudulent conveyance, like that alleged here. *Id.* § 871 cmt. a ("[T]he rule applies when title to land has been obtained by fraud . . . and has been transferred to one other than a bona fide purchaser, in which case, until its sale by the transferee, the original owner's sole redress against the transferee is by an action seeking its recovery."). That is, the common law concept of "fraud" as distilled by the Restatement to which the Court directs us extends beyond fraudulent misrepresentations to at least include fraudulent conveyances. *See id.*; *see also id.* § 871 cmt. e.

This comports with other examples of the common understanding of "fraud." *See McClellan*, 217 F.3d at 893 ("No learned inquiry into the history of fraud is necessary to establish that [fraud] is not limited to misrepresentations and misleading omissions."). As the leading treatise on bankruptcy explains, "[a]ctual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another . . . ." 4 *Collier on Bankruptcy* ¶ 523.08[1][e] (A.N. Resnick & H.J. Sommer, eds., 16th ed. 2015). This "generic term" has frequently been

used to "embrace[] all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth." *McClellan*, 217 F.3d at 893 (quoting *Stapleton* v. *Holt*, 250 P.2d 451, 453-54 (Okla. 1952)). And, as relevant here, "when a debtor transfers property to a third party without adequate consideration" to hinder her creditors, this "is deemed fraud on [her] creditors." *Id.* at 894 (collecting cases); *see also, e.g.*, R.I. UFTA, R.I. Gen. Laws § 6-16-1 *et seq.* (providing remedies for *fraudulent* conveyances); *Spaziano* v. *Spaziano*, 410 A.2d 113, 114-15 (R.I. 1980); *Jorden* v. *Ball*, 258 N.E.2d 736, 737 (Mass. 1970).[7]

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

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

cases of *actual*, as opposed to merely constructive, fraud. *See Spigel*, 260 F.3d at 32 ("[W]e have said that the statutory language does not 'remotely suggest that nondischargeability attaches to any claim other than one which arises as a direct result of the debtor's [fraudulent conduct].'" (quoting *Century 21*, 16 F.3d at 10)); *Palmacci*, 121 F.3d at 788 (emphasizing that § 523(a)(2)(A) "requires a showing of *actual* or positive fraud, not merely fraud *implied by law*" (quoting *Anastas* v. *Am. Sav. Bank* (*In re Anastas*), 94 F.3d 1280, 1286 & n.3 (9th Cir. 1996))). That is, the debtor-transferee must herself be "guilty of intent to defraud" and not merely be the passive recipient of a fraudulent conveyance. *See McClellan*, 217 F.3d at 894 (noting that fraud is "constructive if the only evidence of it is the inadequacy of the consideration"). Such intent may be inferred from her acceptance of a transfer that she knew was made with the purpose of hindering the transferor's creditor(s), but it may not be implied as a matter of law. *See Neal* v. *Clark*, 95 U.S. 704, 707-09 (1877) (distinguishing "actual fraud" from "constructive fraud" which "may exist without the imputation of bad faith or immorality").

Our reading is confirmed by the structure of the text and the legislative history. "'[A]ctual fraud' [was] added as a ground for exception from discharge" under § 523(a)(2)(A) in 1978. S. Rep. No. 95-989, at 78 (1978); H.R. Rep. No. 95-595, at 364 (1977). That provision now "explicitly lists both 'actual fraud' and 'false representations' as grounds for denying a discharge." *Spigel*, 260 F.3d at 33 n.7. We agree with the Seventh Circuit that this distinction must have meaning, and that the most obvious meaning is the one that comports with common law

understanding: "actual fraud is broader than misrepresentation." *McClellan*, 217 F.3d at 893.

Indeed, this is confirmed by the Legislative Statements concerning the change, which reveal that the drafters specifically contemplated not only a broader reading of "actual fraud," but that debt incurred through (actually) fraudulent conveyances would be barred from discharge under § 523(a)(2)(A). The Legislative Statement concerning § 523(a)(2)(A) is express that the addition "is intended to codify current case law, [like] *Neal* v. *Clark*, 95 U.S. 704 (18[7]7)." *See* 11 U.S.C. § 523, Legislative Statements (explaining that § 523(a)(2)(A) is limited to "actual or positive fraud rather than fraud implied by law"). That case, *Neal* v. *Clark*, presumed that the Bankruptcy Code exempted from discharge as a "debt created by . . . fraud" at least some debts incurred through receipt of a fraudulent conveyance. *See Neal*, 95 U.S. at 706-09 (holding that debt created through receipt of a fraudulent conveyance must be actual fraud, not merely constructive fraud, to bar from discharge in bankruptcy); Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517, 533; *cf. id*. ch. 176, § 35, 14 Stat. at 534.[8]

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

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

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

"The history of the fraud exception reinforces our reading of § 523(a)(2)(A)." *Cohen* v. *de la Cruz*, 523 U.S. 213, 221 (1998). The bankruptcy practices at issue in Neal and codified by § 523(a)(2)(A) concerned Section 33 of the Bankruptcy Act of 1867, which barred debts "created by . . . fraud." Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. at 533. The Bankruptcy Act of 1898 similarly prohibited discharge of debts that "are judgments in actions for frauds, or obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another" under Section 17(a)(2).[9] Bankruptcy Act of 1898, ch. 541, § 17(a)(2), 30 Stat. 544, 550; *Cohen*, 523 U.S. at 221. Subsequent amendments retained the "willful and malicious injuries" language until 1970, when "willful and malicious conversion of the property of another" was substituted. *See* 11 U.S.C. § 35(a)(2) (1976); Act of Oct. 19, 1970, Pub. L. No. 91-467, sec. 5-6, §§ 17(a)(2), 17(a)(8), 84 Stat. 990, 992. This substituted language preserved the breadth of the fraud exception articulated in Section 17(a)(2), the predecessor of § 523(a)(2)(A).[10] *Cf. Black's Law Dictionary* 406 (10th

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[9] Section 17(a)(4) of the Bankruptcy Act of 1898 also prohibited discharge of debts "created by [debtor's] fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." 30 Stat. at 550-51. This appears to be the precursor to § 523(a)(4) of the modern Bankruptcy Code, which prohibits discharge (including Chapter 13 discharge) of debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *See* 11 U.S.C. §§ 523(a)(4), 1328(a)(2).

[10] This "willful and malicious conversion" is distinct from the exception to discharge now codified at § 523(a)(6) for "willful and malicious injury by the debtor to another entity or to the property of another entity." *See* 11 U.S.C. § 35(a)(8) (1976) (bar-

ed. 2014) (defining "conversion" as "an act or series of acts of willful interference, without lawful justification, with an item of property in a manner inconsistent with another's right, whereby that other person is deprived of the use and possession of the property").

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

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ring discharge of debts that "are liabilities for willful and malicious injuries to the person or property of another other than conversion *as excepted* under clause (2) of this subdivision" (emphasis added)).

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

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

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

Her argument, charitably read, begins with the assertion that Ms. Lawson's alleged conduct more readily falls within the nondischargeability provision of 11 U.S.C. § 523(a)(6).[12] *Cf. McClellan*, 217 F.3d at 896 (Ripple, J., concurring). Because that provision bars discharge of any debt "for willful and malicious injury by the debtor to another entity," 11 U.S.C. § 523(a)(6), Ms. Lawson argues that it "provides a far more direct avenue for dealing with a situation such as [this]" where the debtor allegedly accepted a

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

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

fraudulent conveyance specifically to impede the injured party's attempt to collect from another. *McClellan*, 217 F.3d at 896 (Ripple, J., concurring). As Judge Ripple observed, § 523(a)(6) has been used to prevent discharge of exactly this sort. *See id.* at 898 (discussing *Murray* v. *Bammer* (*In re Bammer*), 131 F.3d 788 (9th Cir. 1997) (en banc)); *but see id.* at 899 n.1 (conceding that the Ninth Circuit later limited its holding where the fraudulent transferee filed for bankruptcy before the plaintiff, who did not have a security interest, obtained a judgment against the transferee for the transfer).

Against this backdrop, Ms. Lawson argues that the distinction between Chapter 13 and Chapter 7 discharge provides a reason to follow Judge Ripple's suggested construction, and to find the alleged conduct to be covered under § 523(a)(6), not § 523(a)(2). This is because Chapter 13, which provides for a broader discharge than Chapter 7, does not bar the discharge of debts specified in § 523(a)(6), except in limited circumstances not relevant here.[13] *See* 11 U.S.C. § 1328(a)(2); *United Student Aid Funds*, 559 U.S. at 268 ("[D]ischarge under Chapter 13 'is broader than the discharge received in any other chapter.'" (quoting 8 *Collier on Bankruptcy* ¶ 1328.01 (rev. 15th ed. 2008))).

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

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

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

However, that amendment did not completely remove all "willful and malicious injuries" to a creditor's property from the scope of the fraud exception in Section 17(a)(2). Rather, Section 17(a)(2) continued to bar discharge of liabilities "for willful and malicious conversion of the property of another," like willful and malicious receipt of a fraudulent conveyance. *See Black's Law Dictionary* 406 ("[C]onversion . . . . include[s] such acts as taking possession, refusing to give up on demand, disposing of the goods to a third person, or destroying them." (quoting W. Geldart, *Introduction to English Law* 143 (D.C.M. Yardley ed., 9th ed. 1984))); *cf. Neal*, 95 U.S. 704. By contrast, the new provision that preceded § 523(a)(6) barred discharge of debts that "are liabilities for willful and malicious injuries to the person or property of another *other than conversion as excepted under clause (2) of this subdivision*." *See* 11 U.S.C. § 35(a)(8) (1976) (emphasis added).

The notes to the re-codification of these provisions under the Bankruptcy Reform Act of 1978 do not clearly indicate an intention to alter their relative scope with respect to the means by which fraud may be perpetrated. "[A]ctual fraud" was added to § 523(a)(2)(A) expressly for the purpose, as discussed, of "codify[ing] current case law" concerning fraud. *See* 11 U.S.C. § 523, Legislative Statements (citing

Neal, 95 U.S. 704 (holding that receipt of a fraudulent conveyance must "involv[e] . . . intentional wrong" to be nondischargeable)). Although there is some ambiguity about which "willful and malicious conversion[s]" are subsumed under § 523(a)(6) rather than § 523(a)(2),[14] there is not "a clear indication that Congress intended . . . a departure" that would limit the means by which fraud might be perpetrated for purposes of § 523(a)(2)(A). *See Cohen*, 523 U.S. at 221-22. Accordingly, we decline to find one. *See id.* (noting that absent such an indication, we should not "read the Bankruptcy Code to erode past bankruptcy practice").

The continued inclusion of (actual) fraudulent conveyance within § 523(a)(2) is consistent with Congress's "conclu[sion] that preventing fraud is more important than letting defrauders start over with a clean slate." *McClellan*, 217 F.3d at 893 (quoting *Mayer* v. *Spanel Int'l, Ltd.* (*In re Mayer*), 51 F.3d 670, 674 (7th Cir. 1995)); *see also Grogan*, 498 U.S. at 286-87. This is because it prevents Chapter 13, as well as Chapter 7, from becoming "an engine for fraud" by barring from *both* types of discharge debts obtained by fraudulent conveyance. *See* 11 U.S.C.

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

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

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

C. *Narrowness*

Finally, there may be some concern that finding that the *Palmacci* test is not the exclusive test for "actual fraud" under § 523(a)(2)(A) untethers the "actual fraud" requirement from a narrow, principled approach to its construction. *Cf. Blacksmith Invs., LLC* v. *Woodford* (*In re Woodford*), 403 B.R. 177, 188-89 (Bankr. D. Mass. 2009); 43 R.E. Williams *Am. Jur. Proof of Facts* § 21 (3d ed. 2015) (discussing the

difficulties in applying § 523(a)(2)(A) to debts created by credit card fraud). The *Palmacci* test provides a narrow construction with clear elements.[15] If, as the Seventh Circuit suggests, "[n]o definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated," then how is the fraud exception to be narrowly construed? *Cf. McClellan*, 217 F.3d at 893 (quoting *Stapleton*, 250 P.2d at 453-54).

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

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

> 1) the debtor made a knowingly false representation or one made in reckless disregard of the truth, 2) the debtor intended to deceive, 3) the debtor intended to induce the creditor to rely upon the false statement, 4) the creditor actually relied upon the misrepresentation, 5) the creditor's reliance was justifiable, and 6) the reliance upon the false statement caused damage.

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

merely "constructive fraud" as implied by law). But we make two observations.

First, we observe that, while there are other ways to give meaning to the distinction between "actual fraud" and "false representations" under § 523(a)(2)(A), they are not the most narrow available, nor are they consistent with the fraud exception's history. *Cf., e.g.*, *Field*, 516 U.S. at 70 n.8 (declining to decide if a different type of reliance is required under "false pretense" or "false representation"); *Mayer* v. *Spanel Int'l, Ltd.* (*In re Mayer*), 51 F.3d 670, 674 (7th Cir. 1995) (Easterbrook, J.) (suggesting without deciding that "false pretense" or "false representation" may carry a different scienter requirement); Restatement (Second) of Torts §§ 525 *et seq.*, 550 *et seq.* (1977) (discussing related torts of fraudulent misrepresentation, nondisclosure, negligent misrepresentation, and innocent misrepresentation). Rather, reading "false pretenses, false representations, and actual fraud" to be limited, roughly, to mean "fraudulent misrepresentation and other actual frauds" would provide the most consistent and narrow reading of § 523(a)(2)(A) by barring from discharge only those debts that "'arise[] as a direct result of the debtor's [fraudulent conduct].'" *Spigel*, 260 F.3d at 32 (quoting *Century 21*, 16 F.3d at 10); *cf. Mayer*, 51 F.3d at 674 (lamenting that courts have consistently read a culpable intent requirement into the "false pretenses" and "false representation[s]" language of the fraud exception). We need not decide today whether to adopt such a reading. Our point is only that our construction, far from broadening the fraud exception, permits the most narrow construction possible.

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

III.

Finally, Ms. Lawson argues in the alternative that Sauer's complaint fails under our newly adopted standard because Sauer has alleged only *constructive* fraud. *See McClellan*, 217 F.3d at 894. But while our holding is emphatically limited to cases of *actual*, as opposed to merely constructive, fraud, and the heightened pleading requirements for fraud remain applicable, we decline to reach the issue. *See* Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009. *Compare McClellan*, 217 F.3d at 894 (noting that fraud is "constructive if the only evidence of it is the inadequacy of the consideration"), *with Bell Atl. Corp.* v. *Twombly*, 550 U.S. 544, 556 (2007) (requiring under notice pleading standards factual allegations "suggestive enough" to make a claim for "conspiracy plausible"). *Cf. N. Am. Catholic Educ.*, 567 F.3d at 16 (refusing "to assume that no amendment could rescue certain of the claims").

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

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

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

APPENDIX B

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. RI 14-009

Bankruptcy Case No. 13-10752-DF
Adversary Proceeding No. 13-01037-DF

CARRIE D. LAWSON,
Debtor.

SAUER INCORPORATED,
d/b/a Sauer Southeast,
Plaintiff-Appellant,

v.

CARRIE D. LAWSON,
Defendant-Appellee.

Deasy, Kornreich, and Bailey, U.S. Bankruptcy Appellate Panel Judges.

ORDER GRANTING PETITION FOR CERTIFICATION OF DIRECT APPEAL

Before the Panel is the Petition for Certification of Direct Appeal to the First Circuit Court of Appeals Pursuant to 28 U.S.C. § 158(d)(2) (the "Petition") filed by appellant Sauer Incorporated ("Sauer"). In the Petition, Sauer asks this Panel to certify a direct appeal to the U.S. Court of Appeals for the First Circuit (the "First Circuit") of the bankruptcy court's February 3, 2014 Decision and Order (the "Dismissal Order") granting Carrie D. Lawson's motion to dismiss Sauer's adversary proceeding. The primary question on appeal is whether a debt incurred through "actual fraud" (but not by the debtor's misrepresentations) should fall within the nondischargeability provision of § 523(a)(2)(A), which ex-

cepts from discharge debts arising from "false pretenses, a false representation, or actual fraud."[1]

For the reasons set forth below, the Petition is **GRANTED.**

BACKGROUND

In March 2013, Carrie D. Lawson (the "Debtor") filed a chapter 13 petition. Thereafter, Sauer commenced an adversary proceeding against the Debtor seeking a determination that a debt allegedly owed by the Debtor was nondischargeable pursuant to § 523(a)(2)(A). In its complaint, Sauer alleged that the Debtor colluded with her father and knowingly received money through a fraudulent transfer, thereby incurring a debt to Sauer with actual fraudulent intent to hinder and delay Sauer from collecting money owed by the Debtor's father. Sauer did not allege any false representation by the Debtor in connection with the incurrence of the debt.

The Debtor moved to dismiss the complaint under Bankruptcy Rule 7012(b) (incorporating Fed. R. Civ. P. 12(b)(6)) for failure to state a claim upon which relief could be granted. According to the Debtor, because the complaint alleged fraud, it was required to meet the heightened pleadings standard of Fed. R. Civ. P. 9(b), which provides that "in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Moreover, the Debtor contended, a plaintiff must

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[1] Unless expressly stated otherwise, all references to "Bankruptcy Code" or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 101, *et seq.* All references to "Bankruptcy Rule" shall be to the Federal Rules of Bankruptcy Procedure.

plead "the who, what, where, and when of the allegedly false or fraudulent representation." Sauer, the Debtor argued, failed to do so because it did not allege a false representation by the Debtor in connection with the incurrence of the debt. According to the Debtor, because Sauer's complaint lacked an allegation of misrepresentation, one of the elements identified by the First Circuit for a debt to be nondischargeable under § 523(a)(2)(A)[2], the complaint should be dismissed.

In response, Sauer conceded that the complaint did not satisfy the *Spigel/ Palmacci* criteria. Instead, Sauer argued that the *Spigel/ Palmacci* test should not be determinative, and that the fraud exception to dischargeability under § 523(a)(2)(A) should not be limited to cases involving misrepresentation. In support, Sauer cited the decision of the U.S. Court of Appeals for the Seventh Circuit in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), and its progeny, including decisions of the bankruptcy appellate panels of the Sixth and Tenth Circuits, which expanded the nondischargeability of debts under § 523(a)(2)(A) beyond Spigel/Palmacci's limited application to false representations. *See Diamond v. Vick-*

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[2] It is well established in the First Circuit that for a debt to be nondischargeable under § 523(a)(2)(A), "a creditor must show that: (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth; (2) the debtor intended to deceive, i.e., scienter; (3) the debtor intended to induce the creditor to rely upon the false statement; (4) the creditor actually relied upon the misrepresentation; (5) the creditor's reliance was justifiable; and (6) the reliance on the false statement caused damage." *McCrory v. Spigel*, 260 F.3d 27, 32 (1st Cir. 2001) (citing *Palmacci v. Umpierrez*, 121 F.3d 781, 786 (1st Cir. 1997)).

ery (In re Vickery), 488 B.R. 680 (B.A.P. 10th Cir. 2013); *Mellon Bank v. Vitanovich (In re Vitanovich)*, 259 B.R. 873 (B.A.P. 6th Cir. 2001). Sauer argued that the McClellan court's expanded interpretation of § 523(a)(2)(A) should be applied here because the Debtor engaged in "actual fraud" by knowingly colluding with her father to make fraudulent transfers to her with the intent to hinder Sauer from collecting money owed by her father.

To counter this argument, the Debtor emphasized that the First Circuit has taken no position on the validity of *McClellan*'s analysis of the term "actual fraud" in § 523(a)(2)(A). Furthermore, the Debtor pointed to the conclusions of two Massachusetts bankruptcy courts that *McClellan* is inconsistent with First Circuit precedent and with Supreme Court precedent as set forth in *Field v. Mans*, 516 U.S. 59 (1995). *See Morrissett v. Sorbera (In re Sorbera)*, 483 B.R. 580 (Bankr. D. Mass. 2012); *Blacksmith Invs., LLC v. Woodford (In re Woodford)*, 403 B.R. 177, 187-89 (Bankr. D. Mass. 2009).

After a hearing, the bankruptcy court concluded that because Sauer did not allege that the Debtor made a false representation, it did not satisfy the elements of a nondischargeability claim under § 523(a)(2)(A), and dismissal was warranted. In so holding, the bankruptcy court first examined the Seventh Circuit's analysis and holding in *McClellan*, where the question before the court was whether misrepresentation is the only type of fraud that comes within the purview of the § 523(a)(2)(A) exception for "actual fraud." It concluded that because the statute lists both "actual fraud" and "false representations" as grounds for denying a discharge, and because nothing in *Field v. Mans* suggested that mis-

representation is the only type of fraud that can give rise to a debt that is nondischargeable under § 523(a)(2)(A), "actual fraud" encompasses more than misrepresentations.

Next, the bankruptcy court considered First Circuit precedent. The court noted that the First Circuit has only commented on *McClellan* and the term "actual fraud" once, and, while noting that there are differences between *Palmacci* and *McClellan*, it stated that it was not deciding whether to adopt *McClellan's* reasoning. *See Spigel*, 260 F.3d at 32. The bankruptcy court noted that although dicta in *Spigel* "might be viewed as an invitation for a lower court under the right set of facts to adopt the broader construction of § 523(a)(2)(A) enunciated in *McClellan*," it was declining to adopt such an interpretation without more clear direction from the First Circuit, an approach followed by the bankruptcy courts in *Woodford*, *supra*, and *Sorbera*, *supra*.

Ultimately, the bankruptcy court was persuaded by the reasoning in *Woodford* and *Sorbera*, stating as follows:

> The First Circuit has directed that exceptions to discharge must be narrowly construed and that a creditor bears the burden to show that its claim comes squarely within an exception enumerated in the Bankruptcy Code. *See Spigel*, 260 F.3d at 32. Sauer has not met that burden. The Debtor's actions, lacking a false representation, do not come squarely with the parameters of "actual fraud" under § 523(a)(2)(A) as currently construed by the First Circuit.

According to the court:

> This Court is duty-bound to apply the law enacted by Congress as interpreted by the United States Supreme Court and the United States Court of Appeals for the First Circuit. Based on that precedent, the Court concludes that in this circuit a misrepresentation by a debtor to a creditor is an essential element of establishing a basis for the nondischarge of a debt under § 523(a)(2)(A). Consequently, while the outcome may seem harsh, the Court is constrained to hold that Sauer has failed to establish that the debt owed by the Debtor is nondischargeable under this provision.

Thus, the bankruptcy court entered the order dismissing Sauer's adversary proceeding. Sauer filed a notice of appeal on February 14, 2014, and on April 4, 2014, it filed with the bankruptcy court the Petition requesting certification of a direct appeal to the First Circuit. On April 10, 2014, the bankruptcy court transferred the Petition to the Panel for disposition.

DISCUSSION

28 U.S.C. § 158(d)(2) permits direct appeals from the bankruptcy court to the court of appeals in certain circumstances. Certification pursuant to § 158(d)(2) is a two-step process. *Jaffe v. Samsung Elecs. Co. (In re Qimonda AG)*, 470 B.R. 374, 383 (E.D. Va. 2012). First, the bankruptcy court, district court or bankruptcy appellate panel involved must certify that at least one of the statutory conditions exists. 28 U.S.C. § 158(d)(2)(A). Second, the court of appeals must authorize the direct appeal. *Id*.

With respect to the first step, the bankruptcy court, district court or bankruptcy appellate panel "shall" certify the matter for direct appeal to the court of appeals if it determines that:

> (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;
>
> (ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or
>
> (iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken.

28 U.S.C. § 158(d)(2)(B). Any request for certification must be made not later than 60 days after the entry of the judgment, order or decree. 28 U.S.C. § 158(d)(2)(E). After a certification is made, the court of appeals may in its discretion exercise, or decline to exercise, jurisdiction. *See Weber v. United States Trustee*, 484 F.3d 154, 157 (2d Cir. 2007); *see also Weaver v. Harmon Law Offices, P.C. (In re Weaver)*, 542 F.3d 257 (1st Cir. 2008) (declining to exercise jurisdiction on direct appeal).

To implement this provision, Bankruptcy Rule 8001(f)(2) sets forth where the certification should be made and filed. That rule provides that a certification for direct appeal must be filed "in the court in which a matter is pending . . . ." Fed. R. Bankr. P. 8001(f)(2). A matter is pending in the bankruptcy court until the docketing of the appeal in accordance

with Bankruptcy Rule 8007(b); a matter is pending in the district court or bankruptcy appellate panel after the docketing of the appeal in accordance with Bankruptcy Rule 8007(b). Fed. R. Bankr. P. 8001(f)(2). Only a bankruptcy court may make a certification while the matter is pending in the bankruptcy court. Fed. R. Bankr. P. 8001(f)(2)(A)(i). Only the district court or bankruptcy appellate panel may make a certification while the matter is pending in the district court or bankruptcy appellate panel. Fed. R. Bankr. P. 8001(f)(2)(A)(i).

The bankruptcy court entered the Dismissal Order on February 3, 2014, and Sauer timely filed its notice of appeal on February 14, 2014 and its Petition on April 4, 2014. On April 7, 2014, the clerk of the Panel docketed the appeal. In an order dated April 10, 2014, the bankruptcy court noted that the Petition was properly filed with the bankruptcy court on April 4, 2014, but in light of the Panel's docketing of the appeal on April 7, 2014, the Panel is the appropriate court to address the Petition. *See* Fed. R. Bankr. P. 8001(f)(2); *see also Moyer v. Dutkiewicz (In re Dutkiewicz)*, 403 B.R. 472 (B.A.P. 6th Cir. 2009); *Frye v. Excelsior College (In re Frye)*, 389 B.R. 87, 89-90 (B.A.P. 9th Cir. 2008). Thus, the Petition is properly before the Panel.

Sauer argues that there are grounds to certify a direct appeal under 28 U.S.C. § 158(d)(2)(A)(i), as the Dismissal Order involved a question of law as to which there is no controlling decision in the First Circuit. According to Sauer, this case involves the issue of whether a debt incurred through "actual fraud," rather than by a debtor's misrepresentations, should fall within the nondischargeability provision of § 523(a)(2)(A). Sauer contends that this is a ques-

tion of first impression for the First Circuit. According to Sauer, although the First Circuit in *Spigel* noted that *McClellan* "called into question whether the *Palmacci* test should be properly considered the exclusive test to determine nondischargability under § 523(a)(2)(A)," it ultimately stated that "we do not decide whether we would adopt the Seventh Circuit's reasoning," leaving the question unanswered. Sauer argues that, based on the facts of this case, where the alleged debt arose from the Debtor's actual fraud, "this issue is ripe for the First Circuit . . . to decide whether to adopt the Seventh Circuit's reasoning or restrict § 523(a)(2)(A)'s nondischargeability for 'false pretenses, a false representation, or actual fraud' to cases where misrepresentations caused the debt."

We disagree with Sauer as there is indeed controlling authority in the First Circuit as to the elements for establishing nondischargeability under § 523(a)(2)(A). It is well established in the First Circuit that for a debt to be nondischargeable under § 523(a)(2)(A), "a creditor must show that: (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth; (2) the debtor intended to deceive, i.e., scienter; (3) the debtor intended to induce the creditor to rely upon the false statement; (4) the creditor actually relied upon the misrepresentation; (5) the creditor's reliance was justifiable; and (6) the reliance on the false statement caused damage." *Spigel*, 260 F.3d at 32 (citing *Palmacci*, 121 F.3d at 786). As the bankruptcy court stated in *Woodford*, *Spigel* neither "adopted" nor "unequivocally rejected" *McClellan*, and, therefore, the *Spigel/Palmacci* test remains the controlling law in the First Circuit. 403 B.R. at 187.

The Panel concludes, however, that certification is appropriate because the issue raised on appeal "involves a matter of public importance." *See* 28 U.S.C. § 158(d)(2)(A)(i). As an alternative ground for certifying a direct appeal, a case involving a matter of public importance can exist where there is controlling precedent in the court of appeals, but resolution of the legal question will advance "the cause of jurisprudence." *Collier on Bankruptcy* at ¶ 5.06[4][b]. As discussed above, the Seventh Circuit and others have expanded the meaning of fraud under § 523(a)(2)(A) beyond that set forth in *Palmacci*, and the First Circuit, while noting the other authority, has neither adopted nor rejected that approach. *See Spigel*, *supra*. If the Panel were to decide the appeal, it would be bound by the existing law from the First Circuit in *Spigel/ Palmacci*. *McClellan*, and its progeny, however, raise issues regarding the appropriate boundaries of § 523(a)(2)(A). In light of the foregoing, the Panel concludes that it is appropriate for the First Circuit to resolve the issue raised in the appeal.

CONCLUSION

For the reasons set above, the Petition is **GRANTED**.

FOR THE PANEL:

Dated: May 2, 2014 By: */s/ Mary P. Sharon*
Mary P. Sharon, Clerk

[cc: Hon. Diane Finkle, Clerk, U.S. Bankruptcy Court, District of Rhode Island; and U.S. Michael Jacobs, Esq., Brian LaPlante, Esq., Christopher Lefebvre, Esq.]

APPENDIX C

UNITED STATES BANKRUPTCY COURT
DISTRICT OF RHODE ISLAND

In re: CARRIE D. LAWSON, Debtor
BK No: 13-10752
Chapter 13

SAUER INCORPORATED d/b/a
SAUER SOUTHEAST, Plaintiff
v.
CARRIE D. LAWSON, Defendant.
A.P. No. 13-01037

DECISION AND ORDER

The Debtor-Defendant Carrie D. Lawson moves to dismiss this adversary proceeding in which Plaintiff Sauer Incorporated seeks a determination that debt owed by the Debtor is nondischargeable pursuant to Bankruptcy Code § 523(a)(2)(A).[1] The linchpin of this case is whether in this circuit a debt incurred as a result of a debtor's "actual fraud" in the absence of any misrepresentation by the debtor falls within the scope of this nondischarge provision. Sauer alleges that the Debtor colluded with her father and knowingly received money through a fraudulent transfer, thereby incurring a debt to Sauer with actual fraudulent intent to hinder and delay Sauer

[1] Unless otherwise indicated, all references to the "Bankruptcy Code" or to specific statutory sections shall refer to the applicable sections of the United States Code, 11 U.S.C. § 101 *et seq*.

from collecting money owed by the Debtor's father. This Court is duty-bound to apply the law enacted by Congress as interpreted by the United States Supreme Court and the United States Court of Appeals for the First Circuit. Based on that precedent, the Court concludes that in this circuit a misrepresentation by a debtor to a creditor is an essential element of establishing a basis for the nondischarge of a debt under § 523(a)(2)(A). Consequently, while the outcome may seem harsh, the Court is constrained to hold that Sauer has failed to establish that the debt owed by the Debtor is nondischargeable under this provision.

I. JURISDICTION

The Court has jurisdiction over this matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a). This is a core proceeding in accordance with 28 U.S.C. § 157(b)(2)(I).

II. STANDARD OF REVIEW

The Debtor moves to dismiss Sauer's complaint on the basis that it fails to state a claim upon which relief can be granted. *See* Fed. R. Bankr. P. 7012(b) (incorporating Fed. R. Civ. P. 12(b)(6)).[2] In considering the motion to dismiss, the Court must accept as true the facts alleged in the complaint, construe all reasonable inferences in favor of Sauer, and determine whether under those facts and inferences Sauer would be entitled to the relief it seeks. *See Beddall v.*

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[2] Sauer filed its Complaint Objecting to Dischargeability of Debt on June 6, 2013 (Doc. #1), and a First Amended Complaint Objecting to Dischargeability of Debt on July 23, 2013 (Doc. # 14).

State Street Bank and Trust Co., 137 F.3d 12, 16 (1st Cir. 1998).

III. FACTS ALLEGED IN THE COMPLAINT

In January 2007 Sauer filed a civil action in the Rhode Island Superior Court asserting claims including fraud against the Debtor's father, James Lawson. Complaint ¶ 4. Thereafter, in February 2010 Sauer obtained a judgment against Mr. Lawson in the amount of approximately $168,000. *Id*. ¶ 5. Immediately following entry of the judgment, Mr. Lawson transferred approximately $100,000 to Commercial Construction M&C, LLC ("CCMC"), an entity formed by the Debtor but controlled by Mr. Lawson. *Id*. ¶ 6. From February 2010 through early 2011, the Debtor transferred $80,000 of these funds from CCMC to herself. *Id*. ¶ 7.

In March 2011 Mr. Lawson filed a Chapter 13 petition in this Court, and in June 2011 Sauer initiated an adversary proceeding objecting to the discharge of Mr. Lawson's debt to Sauer. *Id*. ¶¶ 8, 9. Subsequently, in August 2011 the Superior Court found Mr. Lawson's post-judgment transfer to CCMC to be fraudulent within the scope of the Rhode Island Uniform Fraudulent Transfers Act, R.I. Gen. Laws § 6-16-1 et seq. ("UFTA"), and issued an execution against CCMC in the amount of the transfer, approximately $100,000. *Id*. ¶ 10. In September 2011 this Court entered a default judgment against Mr. Lawson in Sauer's adversary proceeding, declaring Mr. Lawson's debt to Sauer nondischargeable. *Id*. ¶ 11.

The Superior Court action against Mr. Lawson proceeded, and in March 2013 that court ruled the transfers from CCMC to the Debtor to be fraudulent under the UFTA and issued an execution against the

Debtor in the amount of the $80,000 she transferred from CCMC to herself.[3] *Id.* ¶ 12. In March 2013 the Debtor filed a Chapter 13 petition in this Court, and in June 2013 Sauer initiated the instant adversary proceeding objecting to the discharge of the Debtor's debt to Sauer.

Sauer alleges it "has traced portions of the original Judgment amount (awarded based upon fraud) to CCMC (an insider company owned by [the Debtor] and controlled by [Mr. Lawson]), then subsequently transferred to [the Debtor] directly (an insider as daughter to [Mr. Lawson] and owner of CCMC)." *Id.* ¶ 13. The complaint further alleges that the Debtor "incurred her debt to Sauer through actual fraud by . . . knowingly receiving the fraudulent transfer . . . ." *Id.* ¶ 14. Sauer asserts that as a result of the "continued attempts to conceal and dispose of monies owed to Sauer through fraudulent transfers under the UFTA, Sauer has suffered, and continues to suffer, severe and substantial damages." *Id.* ¶ 15. Sauer prays the debt to Sauer owed by the Debtor be declared nondischargeable pursuant to § 523(a)(2)(A).[4]

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[3] The UFTA enables a creditor to obtain an "attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by applicable statutes and rules of procedure." R.I. Gen. Laws § 6-16-7(a)(2). Sauer moved for issuance of an execution and attachment against the Debtor, and the Superior Court ordered an execution to issue against the Debtor and a writ to issue attaching the Debtor's bank accounts, both in the amount of $80,000. *See* Sauer's Memorandum in Support of Opposition to Debtor's Motion to Dismiss at 3 and *Exhibit 4* thereto.

[4] Sauer also objected to the discharge of the debt pursuant to Bankruptcy Code § 523(a)(6). The Court previously dismissed

IV. THE PARTIES' ARGUMENTS

The Debtor first argues in her motion to dismiss (Doc. #15) that because the complaint alleges fraud it must meet the heightened pleading standard of Fed. R. Civ. P. 9(b), which states: "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Moreover, the Debtor contends that a plaintiff must plead "the who, what, where, and when of the allegedly false or fraudulent representation," citing *Rodi v. S. New Eng. Sch. of Law*, 389 F.3d 5, 15 (1st Cir. 2004). Sauer, the Debtor argues, has failed to do so. This goes to the heart of the question presented by Sauer's complaint and the Debtor's motion; the complaint does not allege a false representation by the Debtor in connection with the incurrence of the debt. Sauer, while conceding that, nonetheless argues that the complaint should not be dismissed because a broader category of fraud is encompassed by the term "actual fraud" used in § 523(a)(2)(A).

The Debtor correctly points out that First Circuit case law regarding the fraud exception to discharge is seemingly well established. For a debt to be nondischargeable under § 523(a)(2)(A), "a creditor must show that (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth; (2) the debtor intended to deceive; (3) the debtor intended to induce the creditor to rely upon the false statement; (4) the creditor actually re-

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that claim because § 1328(a) does not except from discharge in a Chapter 13 case debts of the kind set forth in § 523(a)(6). *See Sauer Inc. v. Lawson (In re Lawson)*, A.P. No. 13-01037, Doc. #23 (Bankr. D.R.I. Oct. 23, 2013).

lied upon the misrepresentation; (5) the creditor's reliance was justifiable; and (6) the reliance on the false statement caused damage." *McCrory v. Spigel (In re Spigel)*, 260 F.3d 27, 32 (1st Cir. 2001) (citing *Palmacci v. Umpierrez*, 121 F.3d 781, 786 (1st Cir. 1997)). The complaint fails to allege those elements – in particular it lacks an allegation of misrepresentation – and therefore, the Debtor maintains, the complaint must be dismissed. Indeed, even Sauer concedes that the complaint does not satisfy the *Spigel/Palmacci* criteria. *See* Sauer's Memorandum in Support of Opposition to Debtor's Motion to Dismiss at 4-5 (Doc. #16) ("Objection").

Instead, Sauer argues that the *Spigel/Palmacci* test should noot be the end of the analysis, that the fraud exception of § 523(a)(2)(A) is not (or should not be) limited to cases of misrepresentation, and that UFTA violations fall within § 523(a)(2)(A)'s "actual fraud" component. To advance this argument, Sauer relies upon the decision of the United States Court of Appeals for the Seventh Circuit in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), and its progeny, including the decisions of two bankruptcy appellate panels that have adopted this viewpoint. *See Diamond v. Vickery (In re Vickery)*, 488 B.R. 680 (10th Cir. B.A.P. 2013); *Mellon Bank v. Vitanovich (In re Vitanovich)*, 259 B.R. 873 (6th Cir. B.A.P. 2001). This interpretation of the term "actual fraud," Sauer reasons, is consistent with existing First Circuit precedent and should be applied to the circumstances of this proceeding because the Debtor allegedly engaged in "actual fraud" by knowingly colluding with her father to effectuate the fraudulent transfers to her with the intent to defeat Sauer's rights as a creditor.

To counter this argument, the Debtor emphasizes that the First Circuit has taken no position on the validity of *McClellan's* analysis of the term "actual fraud" in this statutory provision. Furthermore, the Debtor relies upon the conclusions of two Massachusetts bankruptcy judges, in separate cases, that *McClellan* is inconsistent not only with First Circuit precedent but also with Supreme Court precedent as enunciated in *Field v. Mans*, 516 U.S. 59 (1995). *See Morrissette v. Sorbera (In re Sorbera)*, 483 B.R. 580 (Bankr. D. Mass. 2012) (Bailey, J.); *Blacksmith Investments, LLC v. Woodford (In re Woodford)*, 403 B.R. 177 (Bankr. D. Mass. 2009) (Feeney, J.).

V. DISCUSSION

In relevant part § 523(a)(2)(A) declares nondischargeable a 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 . . . ." Reading the allegations in the complaint, drawing all reasonable inferences in favor of Sauer, and reviewing § 523(a)(2)(A), it would be easy to view the Debtor's alleged conduct as falling within the ambit of this provision. Certainly, the alleged conduct evidences a debt to Sauer arising from money obtained by fraudulent means. However, the term "actual fraud" is not defined in the Bankruptcy Code, and in its historical context and under First Circuit case law the meaning ascribed to this term is not broad enough to encompass the Debtor's actions.

A. *McClellan*

In *McClellan*, the Seventh Circuit reviewed de novo the dismissal of a claim under § 523(a)(2)(A) for failure to state a claim. The facts of that case, which

Sauer argues are "virtually identical" to those in the case at hand, are as follows.

> In 1989 McClellan, the creditor sold his business assets, consisting of ice-making machinery, to the debtor's brother for $200,000, payable in installments. McClellan retained, but did not perfect, a security interest in the machinery. The brother defaulted, owing McClellan more than $100,000. McClellan sued the brother in an Illinois state court, seeking among other things an injunction against the brother's transferring the machinery. With the suit pending, the brother "sold" the machinery to his sister, the debtor. The bill of sale recites the price as $10, and there is no reason to believe that it was more; we may assume therefore that it was a gratuitous transfer. The sister knew about the suit and in accepting the transfer of the machinery was colluding with her brother to thwart McClellan's collection of the debt that her brother owed him. She turned around and sold the machinery for $160,000—and she's not telling anyone what has happened to that money.
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> The sale took place in 1994 and the following year McClellan added the sister as a defendant in his state court action, claiming that her brother's transfer of the machinery to her had been a fraudulent conveyance. Two years later, with the state court suit still pending, the sister filed for bankruptcy under Chapter 7. Fearing lest her debt to him be discharged at the conclusion of the bankruptcy proceeding, McClellan filed an adversary proceeding

> against her seeking to recover the debt that he alleged she owed him as the recipient of a fraudulent transfer of the assets that secured her brother's debt.

McClellan, 217 F.3d at 892.

The bankruptcy court in *McClellan* dismissed the complaint, ruling that the debt was dischargeable, and the district court affirmed, stating that "the Supreme Court [in *Field*] recently scoffed at the idea that a debt could be nondischargeable under the fraud exception of § 523(a)(2)(A) without a showing of material misrepresentation and reliance on the statement." *Id*. The Seventh Circuit disagreed, stating that "*Field* has nothing to do with this case," because in that case the fraud "took the form of misrepresentation, and the only issue was the nature of the reliance that a plaintiff must show to prove fraud in such a case." *Id*. The question it was presented with, the Seventh Circuit explained, was whether misrepresentation is the only type of fraud that comes within the purview of this exception for "actual fraud." It concluded that nothing in *Field* suggests that misrepresentation is the only type of fraud that can give rise to a debt that is not dischargeable under § 523(a)(2)(A) and observed that while numerous cases have assumed that fraud and misrepresentation are synonymous (like *Field*) those cases all involved fraud alleged based upon misrepresentation. *Id*. In that category, the Seventh Circuit placed the opinions of the First Circuit, including *Spigel*, 260 F.3d 27, Sanford Inst. for *Savings v. Gallo*, 156 F.3d 71 (1st Cir. 1998), and *Palmacci*, 121 F.3d 781. No other court of appeals had addressed the precise issue before it, the *McClellan* court determined. Ultimately, the Seventh Circuit was persuaded that "by distin-

guishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation," and reversed the district court's ruling. *McClellan*, 217 F.3d at 893.

Sauer draws upon the concerns expressed in *McClellan* that a narrower interpretation of "actual fraud" would enable a dishonest debtor to abuse bankruptcy law to shield fraudulent conduct and would permit the Debtor in this proceeding before the Court to "turn bankruptcy law into an engine for fraud." *Id*. This broader view adopted by the Seventh Circuit would not apply to an innocent debtor who accepts a fraudulent transfer without the knowledge of the fraudulent character of the transaction or the intent to defraud. *Id*. at 894-95. Sauer alleges that the Debtor, like the debtor in *McClellan*, personally made and accepted the fraudulent transfer from CCMC to herself with the knowledge and intent to thwart Sauer's collection of its debt from Mr. Lawson and CCMC.[5]

B. *The First Circuit on McClellan*

The First Circuit only once has commented on *McClellan* and the term "actual fraud." In *Spigel*, the court first reiterated the accepted rule in this circuit with regard to § 523(a)(2)(A): "[W]e have said that the statutory language does not remotely suggest that nondischargeability attaches to any claim other than one which arises as a direct result of the debtor's misrepresentation or malice," and that in order to establish a debt is not dischargeable under §

[5] Sauer argues that the Debtor's knowledge and intent "is apparent from her participation in her father's [S]uperior [C]ourt action through her provision of affidavits and sworn testimony." Objection at 6, n.1.

523(a)(2)(A) a creditor must show the debtor made a false representation, along with the other elements detailed above. *Spigel*, 260 F.3d at 32. *Spigel* stresses that the statutory language and the legislative history require that the claim of the creditor arise as a "direct result" of the debtor's fraud. *Id.* In a footnote, the First Circuit acknowledged that the Seventh Circuit had adopted a broader interpretation of "actual fraud":

> We note that the Seventh Circuit has recently called into question whether the *Palmacci* test should properly be considered the exclusive test to determine nondischargeability under § 523(a)(2)(A). In *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), that court noted that *Palmacci* and similar cases have adopted a test that focuses solely upon false representations as the total universe of fraud under § 523(a)(2)(A), in large part because false representations were the only fraud before those courts. *Id.* at 892. § 523(a)(2)(A), however, explicitly lists both "actual fraud" and "false representations" as grounds for denying a discharge, a distinction in the statutory language that the *McClellan* court relied upon to hold that "actual fraud" encompasses more than misrepresentations. *Id.* at 892-93; *see also Mellon Bank N.A. v. Vitanovich*, 259 B.R. 873, 876 (6th Cir. BAP 2001) (adopting *McClellan's* definition of actual fraud to evaluate nondischargeability of a debt created by a check kiting scheme). Though there are differences between *McClellan* and *Palmacci* – the most significant of which concerns whether reliance is required – we do not de-

> cide whether we would adopt the Seventh Circuit's reasoning. *McClellan* is consistent with our existing precedent in that it also requires a direct link between the alleged fraud and the creation of the debt. *McClellan*, 217 F.3d at 894-95 (noting that the actual fraud denied discharge under § 523(a)(2)(A), as opposed to constructive fraud, requires a showing that the fraud created the debt); *see also, e.g., Century 21 Balfour Real Estate*, 16 F.3d at 10.

Id. at 32, n.7.

This dicta might be viewed as an invitation for a lower court under the right set of facts to adopt the broader construction of § 523(a)(2)(A) enunciated in *McClellan*. However, this Court concurs with Judges Feeney and Bailey of the Bankruptcy Court for the District of Massachusetts and declines to adopt such an interpretation. Based on *Field* and First Circuit precedent, *Spigel* should not be regarded as such an invitation without more clear direction from the First Circuit.

C. *The Massachusetts Bankruptcy Court Decisions*

In *Blacksmith Investments, LLC v. Woodford (In re Woodford)*, 403 B.R. 177 (Bankr. D. Mass. 2009), the plaintiff relied solely on § 523(a)(2)(A) as grounds for seeking nondischargeability of the debtor's debt. The plaintiff had no evidence to support the elements of the *Spigel/Palmacci* test but instead urged the court to adopt the holding of *McClellan* and its progeny. Judge Feeney concluded that the *Spigel/Palmacci* test remained the governing law in the First Circuit, finding that *Spigel* neither "adopt-

ed" nor "unequivocally rejected" *McClellan*. See *Woodford*, 403 B.R. at 184-87. "In the absence of a clear indication from the First Circuit, this Court lacks the sanguinity of the Seventh Circuit in side stepping the decision of the Supreme Court in *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995)." *Id*. at 187.

While the principal issue in *Field* was the reliance a creditor must show under § 523(a)(2)(A), the Supreme Court delved into the historical meaning ascribed to the term "actual fraud" when the Bankruptcy Code was enacted in 1978. Its research revealed that "actual fraud" holds an acquired meaning as a term of art, and that Congress's use of that term in this provision embraced those elements that the common law already had defined the term to include. *See Field*, 516 U.S. at 69 ("It is . . . well established that where Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms."). The "most widely accepted distillation of the common law of torts," and therefore of the concept of "actual fraud," the Supreme Court instructed, was the Restatement (Second) of Torts (1976). *Id*. at 70. Section 523(a)(2)(A) is unchanged from its 1978 enactment, and the meaning of the term "actual fraud" in the statute likewise remains unchanged.

That common law formulation of "actual fraud" is the test enunciated by the First Circuit in *Palmacci* and *Spigel* requiring a misrepresentation. Rejecting *McClellan's* interpretation of "actual fraud," Judge Feeney held that the fraudulent transfer in *Woodford* did not fit within the parameters of common law

"actual fraud" as articulated by the Supreme Court in *Field*. *Woodford*, 403 B.R. at 188. Due to the lack of a clear directive from the First Circuit, Judge Feeney refused to find that the creditor "sustained its burden of establishing all the common law elements required by decisions in this circuit." *Id*. at 189.[6]

More recently Judge Bailey addressed this same issue in *Morrissette v. Sorbera (In re Sorbera)*, *483 B.R. 580 (Bankr. D. Mass. 2012)*, in which a charge of "actual fraud" but no allegation of misrepresentation was lodged against the debtor. After outlining the *Spigel/Palmacci* test for nondischargeability under § 523(a)(2)(A), Judge Bailey agreed with the rationale in *Woodford* and he too declined to adopt the broader interpretation of "actual fraud" espoused in *McClellan*. "Judge Feeney held that *McClellan's* reading of actual fraud was inconsistent with the Supreme Court's interpretation of that term and, accordingly, limited it to the definition provided by the First Circuit in *Spigel*." *Sorbera*, 483 B.R. at 586. Judge Bailey emphasized the two compelling reasons discussed in *Woodford* as the basis for his rejecting the expansive view of *McClellan*:

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[6] Shortly after *Woodford*, Judge Feeney was presented with another case involving § 523(a)(2)(A) and the issue of "actual fraud." *See Bauer v. Colokathis (In re Colokathis)*, 417 B.R. 150 (Bankr. D. Mass. 2009). In *Colokathis*, Judge Feeney determined that the Chapter 7 debtor's debt was not dischargeable pursuant to §§ 523(a)(4) and 523(a)(6), but she also observed that the debtor's conduct (theft of the plaintiff's identity, among other things) "would satisfy the definition of actual fraud under 11 U.S.C. § 523(a)(2)(A) adopted by [*McClellan*]." *Id.* at 161. Unfortunately for Sauer, whose claim is asserted *only* under § 523(a)(2)(A), the Court does not have the luxury of finding nondischargeability under another subsection of § 523(a).

> First, in *Field v. Mans*, the Supreme Court explained that actual fraud under § 523(a)(2)(A) carries the common law elements of fraudulent misrepresentation found in the Restatement (Second) of Torts (1976). . . . Second, the bankruptcy court is "bound by the elements comprising the common law formulation of 'actual fraud' enunciated by the [First Circuit] in *Spigel*," which include evidence of a misrepresentation. . . . I agree that for these two reasons, actual fraud under § 523(a)(2)(A) is limited to the standard set forth in *Spigel*.

Id.

D. *The Sauer Debt and its Dischargeability*

The Court is persuaded by the reasoning in *Woodford* and *Sorbera*. The First Circuit has directed that exceptions to discharge must be narrowly construed and that a creditor bears the burden to show that its claim comes squarely within an exception enumerated in the Bankruptcy Code. *See Spigel*, 260 F.3d at 32. Sauer has not met that burden. The Debtor's actions, lacking a false representation, do not come squarely with the parameters of "actual fraud" under § 523(a)(2)(A) as currently construed by the First Circuit.

In addition to the reasons identified in *Woodford*, in this Court's opinion there is yet another compelling reason to adhere to the First Circuit requirement of a misrepresentation to establish a nondischargeability claim under § 523(a)(2)(A), one rooted in the distinctions between the discharge provisions under Chapter 7 and Chapter 13. This case is, after all, a Chapter 13 case in which the Bank-

ruptcy Code provides a broader discharge than that available in a Chapter 7 case. *See United States Aid Funds v. Espinosa*, 559 U.S. 260, 268 (2010) ("A discharge under Chapter 13 is broader than the discharge received in any other chapter."). A Chapter 13 debtor must in good faith propose a plan to repay some portion of his or her debts, and Bankruptcy Code § 1328(a) affords a Chapter 13 debtor what has been dubbed a "super discharge." *See, e.g., Barbosa v. Solomon*, 235 F.3d 31, 41 (1st Cir. 2000). Even after the 2005 enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), in which Congress narrowed the super discharge available to a Chapter 13 debtor, Congress expressly excluded debts of the kind set forth in § 523(a)(6) from the nondischarge provisions listed in § 1328(a). However, Congress did not amend the original 1978 version of § 523(a)(2)(A). *See supra* note 4. Both the majority and the concurring judge in *McClellan* conceded that the debtor's actions in that case – as the Court might find in this case – would probably fall within the scope of § 523(a)(6) which excepts from discharge debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." *McClellan*, 217 F.3d at 896 ("For completeness we note that it might also be possible to shoehorn the facts of this case into another provision of section 523, the provision that excludes from discharge debts arising from 'willful and malicious injury by the debtor to another entity or to the property of another entity.' 11 U.S.C. § 523(a)(6)."). *See also Colokathis*, 417 B.R. at 150; *Murray v. Bammer (In re Bammer)*, 131 F.3d 788 (9th Cir. 1997). Because *McClellan* involved a Chapter 7 case, § 523(a)(6) was available to the claimant and, as stated in the concurring opinion, served as an independent ground for

nondischarge of the debtor's debt. *McClellan*, 217 F.3d at 896 ("Section 523(a)(6), however, more easily covers our facts because it reaches any debt for willful and malicious injury to another's property. I think it is important to point out that *§ 523(a)(6) provides a far more direct avenue* for dealing with a situation as the one we have before us." (emphasis added)).

To depart from the widely understood common law definition of "actual fraud" under § 523(a)(2)(A) to reach fraudulent conduct in which a misrepresentation is not present would blur the distinction between the broader discharge available under Chapter 13 and the more limited discharge available under Chapter 7 intended by Congress. While that distinction may offend the senses of some and be criticized as unfair when applied to Sauer's debt, the Court is not at liberty to disregard the breadth of the discharge under the Bankruptcy Code extended to a Chapter 13 debtor, nor does the Court have the luxury of disregarding the elements ascribed to the term "actual fraud" under *Field v. Mans* and the First Circuit's *Spigel/Palmacci* test.

VI. CONCLUSION

Sauer, as it concedes, does not allege that the Debtor made a false representation, and therefore, it cannot satisfy the elements of a nondischargeability claim under § 523(a)(2)(A). The Debtor's motion to dismiss is GRANTED.

Dated: February 3, 2014

By the Court

/s/ Diane Finkel
Diane Finkle
U.S. Bankruptcy Judge