No. 15-147

IN THE

Supreme Court of the United States

BRIAN T. SULLIVAN,

Petitioner,

v.

MICHAEL R. GLENN, JR. AND MICHELE A. GLENN,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITIONER'S REPLY BRIEF

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ARGUMENT

Respondents concede that "a split exists among the circuits" over the meaning of 11 U.S.C. § 523(a)(2)(A)'s fraud exception. Opp. 1. Respondents also concede that "[a]t some point, the Court may wish to hear a case to resolve this conflict." *Id.*[1] The Brief in Opposition only confirms that the time is now.

Section 523(a)(2)(A) of the Bankruptcy Code excepts from discharge in bankruptcy "any debt … for money … obtained by … false pretenses, a false representation, or actual fraud[.]" "[A]ny debt" means *any* debt. So a "debt incurred as a result of fraud cannot be discharged even if the debtor did not know or had no reason to know that his agent was acting fraudulently." *In re Quinlivan*, 434 F.3d 314, 320 (5th Cir. 2005). Despite the Bankruptcy Code's unqualified language, the court below joined the Eighth Circuit in grafting an exception onto the text for debts obtained by the actual fraud of a debtor's agent, where the debtor himself did not have knowledge of the agent's fraud. Three circuits disagree, properly holding that a debt obtained by the actual fraud of a debtor's agent cannot be

[1] The petition for certiorari presented a second and independent question concerning the means by which a Supreme Court precedent may be overruled. Pet. I, 25-26. On the advice of new counsel and to simplify his petition for review, Petitioner respectfully withdraws that question and asks this Court to consider only the first question presented.

discharged, regardless of whether the debtor knew or should have known about the agent's fraud.

The Court should grant certiorari to resolve this long-standing conflict. Respondents do not dispute that this is an issue of exceptional importance, and it arises with alarming frequency. Furthermore, this case presents an ideal vehicle to address this pure question of law. Respondents' sole suggestion to the contrary rests on the mistaken belief that this Court would have to take up every preliminary question decided by the Seventh Circuit, and in particular, a subsidiary factual question as to whether Karen Chung was acting as Respondents' agent pursuant to Illinois law. That is plainly wrong. The question Petitioner puts forward is squarely presented and outcome-determinative. This Court should grant review.

I. The Lower Courts Are Starkly Divided Over Whether A Debt Obtained By The Actual Fraud Of A Debtor's Agent Is Dischargeable Under § 523(a)(2)(A) Where The Debtor Lacks Knowledge Of The Fraud.

As Respondents acknowledge, "a split exists among the circuits" over whether a debt obtained by the fraud of a debtor's agent is dischargeable under § 523(a)(2)(A) where the debtor lacks knowledge of the agent's fraud. Opp. 1. Three circuits follow this Court's decision in *Strang v. Bradner*, 114 U.S. 555 (1885); two do not.

Strang interpreted the Act of 1867, which "except[ed] from the operation of a discharge any 'debt created by the fraud or embezzlement of the bankrupt.'" *Id.* at 556 (quoting Rev. Stat. § 5117). Noting first that the term "fraud" in the statute "should be construed to mean positive fraud, or fraud in fact," rather than implied or legal fraud, *id.* at 559, the Court considered whether, where the fraud is committed by someone other than the debtor, the debt is dischargeable. The Court held that it is not. Specifically, the Court held that a debt could not be discharged as to two innocent partners, who had committed no fraud and who had no knowledge of their third partner's fraud, because his fraud, "by virtue of his agency for the partnership," was "imputed" to his partners. *Id*. at 561.

In interpreting § 523(a)(2)(A) of the modern Bankruptcy Code, which does not require that the debt be "created by the fraud or embezzlement of the bankrupt," and instead proscribes more broadly the discharge of any debt that is "obtained by … actual fraud," 11 U.S.C. § 523(a)(2)(A), three circuits properly follow the *Strang* rule. These circuits correctly deny discharge of any debt obtained by the actual fraud of a debtor's agent.

In re Ledford, 970 F.2d 1556, 1561 (6th Cir. 1992), is illustrative. There, one business partner acquired funds for the business by making fraudulent misrepresentations to a creditor. *Id.* at 1558. The company went bankrupt, and the bankruptcy court held that the partner who acted fraudulently was not entitled to a discharge of the debt, but his innocent partner was. *Id.* at 1558-59.

The Sixth Circuit reversed, holding that neither partner was entitled to a discharge of the debt. *Id.* at 1561. Citing *Strang*'s explanation of agency law, the court held that where one partner "perpetrated his fraud while acting on behalf of the partnership," the debt could not be discharged even as to the innocent partner who lacked knowledge of the fraud. *Id.* at 1561-62.

The Fifth and Eleventh Circuits agree. The Eleventh Circuit holds that "a debt may be excepted from discharge when the debtor personally commits actual, positive fraud, and also when such actual fraud is imputed to the debtor under agency principles," even where the debtor is unaware of his agent's fraud. *In re Villa*, 261 F.3d 1148, 1151 (11th Cir. 2001). And the Fifth Circuit holds that under *Strang*, "fraud can be imputed to an innocent partner regardless of his knowledge or involvement for purposes of 11 U.S.C. § 523(a)(2)(A)." *In re Luce*, 960 F.2d 1277, 1282 (5th Cir. 1992) (citation and internal quotation marks omitted).

Thus, according to the Fifth, Sixth, and Eleventh Circuits, the Bankruptcy Code means what it says: A debt obtained by actual fraud may not be discharged, period. A debtor's lack of knowledge of his agent's fraud is no excuse.

Rather than follow the plain language of the Bankruptcy Code, this Court's decision in *Strang*, or the Fifth, Sixth, and Eleventh Circuits, the Seventh Circuit in this case chose to join the Eighth Circuit in holding that an agent's actual fraud does *not*

prevent a discharge of a debt unless the debtor knew or should have known of the agent's fraud.

The Eighth Circuit first reached that mistaken conclusion in *In re Walker*, 726 F.2d 452, 454 (8th Cir. 1984) (per curiam). It held that "[p]roof that a debtor's agent obtains money by fraud does not justify the denial of a discharge to the debtor, unless it is accompanied by proof which demonstrates or justifies an inference that the debtor knew or should have known of the fraud." The Seventh Circuit quoted that holding when it firmly sided with the Eighth Circuit in this case.[2] Pet. App. 5a.

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[2] Bankruptcy courts are divided as well. Some correctly refuse to discharge debts obtained by the actual fraud of a debtor's agent, even without the debtor's knowledge of the fraud. *See, e.g.*, *In re Simone*, 509 B.R. 6, 11 (Bankr. D. Md. 2014); *In re Heinz*, 501 B.R. 746, 760-61 (Bankr. N.D. Ala. 2013), *as amended* (Nov. 13, 2013); *In re Grasso*, 497 B.R. 434, 442-43 (Bankr. E.D. Pa. 2013); *In re Cowin*, 492 B.R. 858, 906 (Bankr. S.D. Tex. 2013) *aff'd*, 538 B.R. 721 (S.D. Tex. 2015); *In re Asbury*, 441 B.R. 629, 635 (Bankr. W.D. Mo. 2010); *In re Richmond*, 429 B.R. 263, 288 (Bankr. E.D. Ark. 2010); *In re Gordon*, 293 B.R. 817, 822 (Bankr. M.D. Ga. 2003); *In re Sestito*, 136 B.R. 602, 605 (Bankr. D. Mass. 1992); *In re Calhoun*, 131 B.R. 757, 760-62 (Bankr. D.D.C. 1991); *In re Ledford*, 127 B.R. 175, 180-85 (M.D. Tenn. 1991), *aff'd*, 970 F.2d 1556 (6th Cir. 1992); *In re Paolino*, 75 B.R. 641, 645-50 (Bankr. E.D. Pa. 1987). Others erroneously hold that a debt can be discharged unless the debtor knew or should have known of his agent's fraud. *See, e.g.*, *In re Obara*, No. 09-01239, 2014 Bankr. LEXIS 2355, at *7 (B.A.P. 9th Cir. May 28, 2014); *In re Huh*, 506 B.R. 257, 266 (B.A.P. 9th Cir. 2014); *In re Futscher*, 58 B.R. 14, 17 (Bankr. S.D. Ohio 1985); *In re Anderson*, 29 B.R. 184, 191 (Bankr. N.D. Iowa 1983).

The *Walker* rule has been sharply criticized, "beginning with the bankruptcy court which heard the case on remand." *In re Calhoun*, 131 B.R. at 761 (citing *In re Walker*, 53 B.R. 174 (Bankr. W.D. Mo. 1985)). And rightly so. *Walker* justified its atextual reading of § 523(a)(2)(A) by relying on cases interpreting a separate statute, which precluded any bankruptcy discharge if the "bankrupt … obtained money or property on credit … by making or publishing or causing to be made or published … a materially false statement in writing respecting his financial condition." 11 U.S.C. § 32(c)(3); 726 F.2d at 454. Section 523(a)(2)(A), in contrast, lacks any requirement that the fraud be committed by the debtor himself. It simply exempts from discharge all debts obtained by actual fraud. There is no basis in the statutory text for the Seventh and Eighth Circuit's requirement that the fraud be procured by the debtor himself or with his knowledge.

To the contrary, § 523(a)(2)(A) "focuses on the character of the debt, not the culpability of the debtor …. Thus, the plain meaning of the statute is that debtors cannot discharge any debts that arise from fraud so long as they are liable to the creditor for the fraud." *In re M.M. Winkler & Assocs.*, 239 F.3d 746, 749 (5th Cir. 2001) (citing Lawrence Ponoroff, *Vicarious Thrills: The Case for Application of Agency Rules in Bankruptcy Dischargeability Litigation*, 70 Tul. L. Rev. 2515, 2542 (1996) (arguing that § 523(a)(2) makes all debts that are the product of fraud nondischargeable)). Section 523(a)(2)(A) is not alone in its categorical approach. Many of § 523(a)'s other subsections pertain to exceptions from discharge that have

nothing to do with a debtor's knowledge or fault. These provisions specify the *types* of debts that—like debts obtained by fraud—are deemed by their nature nondischargeable, such as debts for a tax or customs duty, (a)(1); a domestic support obligation, (a)(5); a fine, penalty, or forfeiture payable to a government unit, (a)(7); and, in some cases, student loans, (a)(8).

The Seventh and Eighth Circuit holdings are also "contrary to the legislative history and proper statutory interpretation of § 523." *In re Bonnanzio*, 91 F.3d 296, 302 (2d Cir. 1996) (discussing § 523(a)(2)(B)). Section 523(a)(2)(A) was "not designed to protect debtors; rather it [wa]s designed to protect the victims of fraud." *In re Quinlivan*, 434 F.3d at 319; *see also* Theresa J. Pulley Radwan, *No Harm, No Foul: Calculation of Nondischargeable Damages in Transactions Tainted by Fraud*, 58 SMU L. Rev. 1385, 1388 (2005) ("Congress designed section 523 of the Bankruptcy Code to protect creditors."). The legislative history thus confirms that *Walker* is wrong, and fraud committed by the debtor's agent is properly imputed to the debtor under § 523(a)(2)(A). 4 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 523.08[3] (16th ed. 2010).

Yet as recently as 2012, the Eighth Circuit itself criticized *Walker* but continued to accept it as binding. *See In re Reuter*, 686 F.3d 511, 518 (8th Cir. 2012) ("We note that a requirement of recklessness" to impute a partner's fraud to a debtor "in order to render such a debt non-dischargeable under § 523(a)(2)(A) … appears to contravene controlling authority established by the Supreme Court in

Strang."). And the Seventh Circuit chose to join the Eighth Circuit in the precedential disposition below. Pet. App. 5a, 8a.

The court of appeals conflict is thus long-standing and entrenched. Three circuits hold that a debt that was procured by actual fraud will not be discharged pursuant to § 523(a)(2)(A), while two circuits hold that such a debt will be discharged unless the debtor knew or had reason to know of his agent's fraud. As the Seventh and Eighth Circuits have recently made clear, the conflict will not resolve itself. This Court's intervention is necessary.

II. This Case Presents An Ideal Vehicle In Which To Resolve The Question Presented.

Respondents do not dispute that the question presented is outcome-determinative in this case. Instead, they simply disagree with the Seventh Circuit's conclusion that the individual who committed the underlying fraud, Karen Chung, was serving as Respondents' agent for purposes of procuring the loan. *See* Pet. App. 4a. (reasoning that "if you hire someone to negotiate a deal for you, subject to your approval, that someone is your agent"). Respondents then contend that "this is not the appropriate case" for "resolving" the conceded circuit split as to § 523(a)(2)(A) because "the threshold issue that the Court would have to resolve if it grants the Petition is whether, under the controlling Illinois law of agency, Karen was acting as Respondents' agent" when she made the misrepresentations. Opp. 5.

That is incorrect. Respondents misunderstand the nature of this Court's certiorari jurisdiction. Resolution of the Question Presented would not require the Court to reexamine whether Chung was in fact serving as Respondents' agent under Illinois law. The Seventh Circuit has already held that she was, and this Court would properly assume the correctness of that decision for purposes of adjudicating this case. Because "Respondents did not cross-petition for certiorari review of this issue," and do not claim that the question of whether Chung was in fact serving as Respondents' agent is independently worthy of review, this Court should "have no occasion to consider it." *Block v. Cmty. Nutrition Inst.*, 467 U.S. 340, 344 n.2 (1984).

Moreover, this Court would not resolve Respondents' fact-bound "State law agency issue" (Opp. 8) anyway, because this Court generally does not decide questions of state law. Specifically, this Court "accord[s] great deference to the interpretation and application of state law by the courts of appeals," and generally "do[es] not question" their conclusions on issues of state law. *Pembaur v. City of Cincinnati*, 475 U.S. 469, 484 & n.13 (1986). Respondents' suggestion that this Court would need to decide if, "under the controlling Illinois law of agency," Chung was in fact "acting as Respondents' agent," Opp. 5, is therefore simply wrong.

In the end, this case cleanly presents an important question of federal law that has split the courts of appeals. It is an ideal vehicle in which to review this pure legal question, and this Court should grant review.

III. This Is An Issue Of Exceptional Importance That Warrants This Court's Immediate Intervention.

Respondents do not dispute that this is an issue of exceptional importance, and it arises with alarming frequency. In addition to the five courts of appeals that have reached the question, it regularly arises in individual bankruptcy cases, including in 13 other decisions in 2015 alone.[3]

Moreover, while all federal statutes should be interpreted uniformly nationwide, the need for uniformity is especially crucial in the bankruptcy context. The Constitution specifically requires "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I,

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[3] *In re Kanter*, B.A.P. No. 15-1059, 2015 Bankr. LEXIS 3471, at *18-19 (B.A.P. 9th Cir. Oct. 13, 2015); *In re Kenneth Keun Sung Lee*, 536 B.R. 848, 862-63 (Bankr. N.D. Cal. 2015); *In re Minardi*, 536 B.R. 171, 189-90 (Bankr. E.D. Tex. 2015); *In re Ramirez*, No. 14-00239, 2015 Bankr. LEXIS 2401, at *20-21 (Bankr. D. Haw. July 21, 2015); *In re Duffie*, 531 B.R. 847, 861 (Bankr. D. Mont. 2015); *In re Hurtado*, No. 09-16160, 2015 Bankr. LEXIS 1690, at *48-49 (Bankr. E.D. Cal. May 18, 2015); *In re Wood*, No. 13-00757, 2015 Bankr. LEXIS 2428 (Bankr. D. Haw. July 22, 2015); *In re Lecong*, No. 14-1286, 2015 Bankr. LEXIS 1547, at *15 (B.A.P. 9th Cir. May 6, 2015); *Aguilar v. Sargis*, No. 14-5290, 2015 U.S. Dist. LEXIS 49348, at *2 (N.D. Ill. Apr. 15, 2015); *In re Hart*, No. 14-1154, 2015 Bankr. LEXIS 601, at *28 (B.A.P. 9th Cir. Feb. 26, 2015); *In re Jenkins*, Nos. 14-1185, 14-1258, 2015 Bankr. LEXIS 578, at *30 (B.A.P. 9th Cir. Feb. 20, 2015); *In re Morse*, 524 B.R. 774, 789 (Bankr. E.D. Tenn. 2015); *In re Shart*, No. 14-1065, 2014 Bankr. LEXIS 4779, at *53 (B.A.P. 9th Cir. Nov. 19, 2014).

§ 8, cl. 4. The "main purpose" of this "geographic uniformity" requirement is "to treat claimants against debtors the same in one area as in another." *Blanchette v. Conn. Gen. Ins. Corps.*, 419 U.S. 102, 180-81 (1974).

As things currently stand, however, a creditor is out of luck if a debtor with an "I didn't know about the fraud" excuse files for bankruptcy in Chicago or St. Louis, but can be made whole if the debtor files in Houston, Cincinnati, or Jacksonville. That patchwork result is indefensible. Pursuant to 28 U.S.C. § 1408(1), a debtor has broad discretion in choosing a venue in which to declare bankruptcy—any venue in which the debtor has maintained a domicile, residence, principal place of business, or principal assets for the past 180 days. As a result, debtors may have multiple venues in which they can seek bankruptcy protection. And with 180 days' foresight—time enough to fend off any serious collection efforts—strategic debtors can manufacture venue by moving their assets or residence before filing for bankruptcy. Thus, whatever the correct answer to the question presented, it should be the same in all venues.

Finally, the Court recently granted certiorari to resolve a split among three circuits over whether "actual fraud" in § 523(a)(2)(A) encompasses only a misrepresentation, or whether it also encompasses a fraudulent transfer scheme. *See* Petition for Writ of Certiorari, *Husky Int'l Elecs., Inc. v. Ritz*, No. 15-145 (granted Nov. 6, 2015). The resolution of *Husky* would not impact the question presented here, because all parties concede that the debt in this case was procured by a misrepresentation. This case

raises the separate but related question, on which five courts of appeals disagree, of what happens when the misrepresentation has been committed by someone other than the debtor himself. The Court should grant certiorari to resolve this split in authority and decide this case in conjunction with *Husky*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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