THE SUPREME COURT, DISCHARGEABILITY AND ACTUAL FRAUD

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INTRODUCTION

Straightforwardly, Bankruptcy Code section 727(a)(2) bars discharge of any debt if the debtor "with intent to hinder, delay, or defraud a creditor" has *made* a fraudulent transfer within a year of the debtor's bankruptcy petition.[1] The Supreme Court has recently ruled that *receiving* a fraudulent transfer gives rise to nondischargeable liability to private creditors where the recipient has filed for bankruptcy. The scope and meaning of this ruling is exceptionally unclear.

In *Husky International Electronics, Inc. v. Ritz*,[2] an insider caused an insolvent company to transfer funds to another affiliated company of which the original insider was a shareholder.[3] A contract creditor of the bankrupt entity took offense and sought to pierce the veil of the bankrupt company to hold the insider liable.[4] The insider responded by filing his own chapter 7 bankruptcy petition. In the insider's bankruptcy, the creditor objected to the discharge of its contract claim—at first unsuccessfully.[5] By the time the case reached the Supreme Court, the corporate veil was not pierced and, alternatively, the breach of contract claim was held to be dischargeable.[6] Although the lower courts never quite got around to piercing any corporate veils, the Supreme Court ruled that the insider had received, or perhaps had sent, a fraudulent transfer to affiliates of the bankrupt company.[7] Accordingly, the debtor was guilty of having obtained "property" by "actual fraud" within the meaning of Bankruptcy Code section 523(a)(2)(A).[8] Accordingly, the insider was not entitled to a discharge of the creditor's breach of contract action.[9]

Everything about this holding is contestable. Was the insider a *transferor* of a fraudulent transfer or a *transferee*? Corporate veil piercing figures in the case. But which corporate veil was being pierced? Numerous corporations were involved. One was the transferor. The rest were transferees. Was the insider being held just for the fraudulent transfer received, or was the insider potentially liable for many millions owed by the transferor corporation to various contract creditors? To make matters worse, it seems very clear that *Husky* was not a fraudulent transfer case at all! Rather, it was a case sounding in embezzlement or conversion of funds.

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[1] 11 U.S.C. § 727(a)(2) (2018).

[2] 136 S. Ct. 1581 (2016).

[3] *Id.* at 1585.

[4] *Id.*

[5] *Id.* (referencing the Fifth Circuit opinion that was reversed by this Court).

[6] *Id.* at 1585–86 ("The District Court held that [the debtor] was personally liable for the debt under [state] law, but that the debt was not 'obtained by . . . actual fraud' under § 523(a)(2)(A) and could be discharged in his bankruptcy. The Fifth Circuit affirmed.").

[7] *Id.* at 1587–88.

[8] *Id.* at 1590 ("Because we must give the phrase 'actual fraud' in § 523(a)(2)(A) the meaning it has long held, we interpret 'actual fraud' to encompass fraudulent conveyance schemes, even when those schemes do not involve a false representation. We therefore reverse the judgment of the Fifth Circuit and remand the case for further proceedings consistent with this opinion.") (citations omitted).

[9] *Id.* at 1585 (explaining that the Bankruptcy Code does not allow debts to be discharged if they are obtained by false pretenses, a false representation, or actual fraud).

The purpose of this Article is to figure out what exactly happened in the *Husky* case, if that is possible, and what the Supreme Court meant in its disposition of it. In pursuit of this challenge, Part I of this Article describes what a fraudulent transfer is. Part II describes what a fraudulent transfer is not—equally relevant to understanding what the Supreme Court hath wrought.

Husky arose from a split in the circuits. Ironically, none of the other circuit court opinions arose in the context of valid fraudulent transfer claims. Part III reviews these opinions and shows why the section 523(a)(2)(A) issue was never properly before these courts. One was not a fraudulent transfer case.[10] The other was a fraudulent transfer case, but the creditor seeking relief did not own the cause of action.[11]

Part IV explains why *Husky* was never properly a fraudulent transfer case. It also shows that the Supreme Court never could decide whether the debtor in *Husky* was the *transferee* of a fraudulent transfer or a *transferor*. Although the case turns on piercing the corporate veil, the Supreme Court failed to identify which of the corporate veils was being pierced.

The Article concludes by "sampling the aleatory delights of Supreme Court jurisprudence."[12] It offers a series of propositions as to what the *Husky* opinion does and does not mean. At least some of these propositions are counterintuitive.

I. WHAT FRAUDULENT TRANSFERS ARE

Fraudulent transfers have a long history, going back, at the very least, to the Institutes of Justinian.[13] By the time of Elizabeth I, a conveyance by a debtor intended to "delaye, hynder or defraude" creditors was voidable by creditors.[14]

To give an example, suppose a debtor (whom I shall call *D*) has a creditor (whom I shall call *C*). *D* owns, say, a gold brick. So far, *D* owns the whole of this brick (the "fee simple absolute" of it), and *C* has no interest in the brick. To obtain a property in the brick, *C* must obtain a judicial lien on it. This requires *C* to obtain a money judgment against *C*, or to obtain a prejudgment attachment of it.[15]

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[10] McClellan v. Cantrell, 217 F.3d 890, 892 (7th Cir. 2000). *McClellan* was actually a conversion case.

[11] Sauer Inc. v. Lawson (*In re* Lawson), 791 F.3d 214, 215, 217 (1st Cir. 2015), *cert. denied*, 136 S. Ct. 2443 (2016). In *Lawson*, a bankruptcy trustee was subrogated to the creditor's fraudulent transfer right and so the private creditor was usurping the bankruptcy trustee's prerogative and was in violation of the automatic stay to boot. *See infra* text accompanying note 129.

[12] 1 GERRARD GLENN, FRAUDULENT CONVEYANCES & PREFERENCES § 85, at 144 (rev. ed. 1940).

[13] *See* Max Radin, *Fraudulent Conveyances at Roman Law*, 18 VA. L. REV. 109, 109 (1931).

[14] 13 Eliz., ch. 5, ¶ 1 (1571).

[15] In New York, for example, a pre-judgment attachment lien arises when the court issues an order of attachment and this order is delivered to the sheriff. *See* N.Y. C.P.L.R. § 6203, 6211 (McKinney 2019). In the post-judgment context, the judgment creditor must arrange for an execution to issue. *Id.* § 5230. A lien arises when the execution is delivered to the sheriff. *Id.* § 5202(a). Alternatively, a lien arises when the judgment creditor obtains a turnover order requiring D or a third party possessing the brick to turn the brick over to the sheriff for sale, or when the judgment creditor obtains the appointment of a receiver to take charge of the brick. *Id.* § 5202(b).

Suppose *D*, however, conveys the brick to a third party (whom I shall call *X*). *D* intends to enrich *X* and intends also to keep the brick out of the hands of *C*, who otherwise is entitled (after judgment) to obtain a writ of execution against the brick. Suppose *X* gives no value to *D* in return for this conveyance. To invoke the language of the Uniform Fraudulent Transfer Act ("UFTA") section 4(a),[16] *D* has made a fraudulent transfer to *X*:

> A transfer made . . . by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made . . . if the debtor made the transfer . . . :
>
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor . . . .[17]

Because the transfer was made with the intent to hinder, delay or defraud, the UFTA gives *C* a remedy:

> In an action for relief against a transfer . . . under this Act, a creditor, subject to the limitations in Section 8, may obtain:
>
> (1) avoidance of the transfer . . . to the extent necessary to satisfy the creditor's claim . . . .[18]

After all these years, it is still unclear what "avoidance" means.[19] The verb "avoid" suggests "to undo." This suggests that *D* still owns the gold brick, and so the sheriff, armed with a writ of execution following *C*'s money judgment, can take the brick away from *X* as if it were still *D*'s brick. Such a view treats the transfer as a non-event. The transfer is *void* in this view. The Supreme Court, on one celebrated occasion, viewed fraudulent transfers in just this way.[20]

But the transfer is not *void*. It is *voidable* at the behest of *C*.[21] If *C* does not step forward and assert her rights (whatever they are), the brick belongs to *X*.

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[16] UNIF. FRAUDULENT TRANSFER ACT § 4(a) (1984). The UFTA has become the law in most states. *See* Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 BUS. LAW. 777, 779 (2015). It is rapidly being transplanted with the largely identical Uniform Voidable Transactions Act. New York has recently succumbed. *See* N.Y. DEBT. & CRED. LAW §§ 270-281-a (effective April 4, 2020).

[17] UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1).

[18] *Id.* § 7(a).

[19] For an exploration, see David Gray Carlson, *The Logical Structure of Fraudulent Transfers and Equitable Subordination*, 45 WM. & MARY L. REV. 157 (2003) [hereinafter Carlson, *Logical Structure*].

[20] *See* Moore v. Bay (*In re* Estate Sassard & Kimball, Inc.), 284 U.S. 4, 3–4 (1931). In *Moore v. Bay*, *C* had a relatively small claim and *D* Corp. granted a very large unperfected security interest to SP. The unperfected hypothecation was, in effect, a fraudulent transfer. Justice Holmes ruled that a fraudulent transfer is no transfer and avoided the entire security interest because a small creditor with avoidance rights existed. *Id.* at 4; *see also* Douglas J. Whaley, *The Dangerous Doctrine of Moore v. Bay*, 82 TEX. L. REV. 73, 75 (2003).

[21] According to the Institutes of Justinian 4.6.6:

Overpowering evidence that this is so is that the UFTA avoids only "to the extent necessary to satisfy the creditor's claim . . . ."[22] Where the value of the property conveyed exceeds *C*'s claim against *D*, the conveyance to *X* is, in part, quite valid.

Because avoidance is only "to the extent necessary," here is what avoidance must mean. *C* is invited to get a judicial lien for the amount of *C*'s money judgment against *X*'s gold brick.[23] X owns the "equity" in the brick (if any).

To illustrate, suppose C obtains a money judgment against D for $10,000 and X's gold brick is worth $50,000. The sheriff, empowered by C's writ of execution, may levy X's brick[24] and hold an execution sale, where some high bidder offers $50,000 for the brick. After the sheriff's takes her statutory fee, the sheriff distributes $10,000 to *C*. The surplus belongs to *X*, the owner of the brick.[25]

On this view, "avoidance" means, or at least enables, the attachment of *C*'s judicial lien to X's brick. *C*'s dependence on a judicial lien on X's property yields an important clue as to what is or is not a fraudulent transfer.

So far, we have considered *D*'s conveyance to *X* according to *D*'s intent to hinder *C*. Notice that, under UFTA section 8, *D*'s insolvency is not strictly required. We need only *D*'s bad intent to hinder a creditor. Nor does it matter whether X paid for the gold brick or received it for no value given back in return. If *X* paid for the brick, however, in good faith and without knowledge of *D*'s bad intent, *X* is given a defense. According to the UFTA section 8(a): "A transfer . . . is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value . . . ."[26]

The requisite bad intent to hinder creditors belongs to *D*. Fraudulent transfer law does not care about *X*'s intent.[27] It only requires that *X* has knowledge of *D*'s bad intent, when *X* has paid value to *D*. If *D* has not paid value, fraudulent transfer law is disinterested in *X*'s knowledge. Donees for no reasonably equivalent value have no defense.

> [I]f any one has transferred his property to another in fraud of his creditors, upon judgment to that effect by the chief principal magistrate, the creditors of the transferor may seize his property, avoid the transfer and recover the things transferred; that is, they may claim that the things have not been transferred at all and accordingly are still within the legal possession of the debtor.

Radin, *supra* note 13.

[22] UNIF. FRAUDULENT TRANSFER ACT § 7(a)(1).

[23] *See* Carlson, *Logical Structure*, *supra* note 19, at 166–68 ("[F]raudulent transfer law stands for the proposition that creditors may impose judicial liens on the property of non-debtors, when such property was conveyed or created by a debtor.").

[24] UNIF. FRAUDULENT TRANSFER ACT § 7(b)(1) ("If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.").

[25] *See* Doster v. Manistee Nat'l Bank, 55 S.W. 137, 142 (Ark. 1900); GLENN, *supra* note 12, § 127a, at 244–45 (stating, under similar circumstances, that upon a sale of property the surplus "must be turned back to the grantee").

[26] UNIF. FRAUDULENT TRANSFER ACT § 8(a).

[27] *See In re* Auto Specialties Mfg. Co., 153 B.R. 547, 500 (W.D. Mich. 1993) ("[F]raudulent conveyance claims arising under 11 U.S.C. § 548(a)(1) . . . [are] based[,] not upon a fraudulent intent by [X], but rests instead upon the fraudulent intent of the [D].").

Rarely is there direct evidence of *D*'s motive in conveying property. Courts therefore resort to "badges of fraud." The UFTA nonexclusively enumerates eleven such badges.[28]

By the early 20th century, in the case of gifts, legislators grew weary of *D*'s claim that the gift was based on love for *X*, not on the strategy of hindering *C*. Therefore, in 1918, the Uniform Law Commission promulgated the Uniform Fraudulent Conveyance Act ("UFCA") and dispensed with the requirement of intent in the case of a gift by an insolvent *D*. According to UFCA section 4: "[e]very conveyance made . . . by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to actual intent if the conveyance is made without a fair consideration."[29]

In contrast, the UFCA described the *original* intentional fraud as "every conveyance made . . . with *actual* intent, as distinguished from intent resumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors."[30]

Gifts struck down under UFCA section 4 came to be called constructive fraudulent transfers.[31] Fraudulent transfers motivated by *D*'s bad intent to hinder creditors were called *actual* fraudulent transfers.

But are fraudulent transfers actually *fraudulent*? The Uniform Laws Commission thought not and renamed the fraudulent transfer as a "voidable transaction."

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[28] According to UFTA § 4(b):

> In determining actual intent under subsection (a)(1), consideration may be given, among other facts, to whether:
>
> (1) the transfer . . . was to an insider;
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> (2) the debtor retained possession or control of the property transferred after the transfer;
>
> (3) the transfer . . . was disclosed or concealed;
>
> (4) before the transfer was made . . . the debtor had been sued or threatened with suit;
>
> (5) the transfer was of substantially all the debtor's assets;
>
> (6) the debtor absconded;
>
> (7) the debtor removed or concealed assets;
>
> (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred . . . ;
>
> (9) the debtor was insolvent or became insolvent after the transfer was made . . . ;
>
> (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
>
> (11) the debtor transferred the execution lien assets of the business to a lienor who transferred the assets to an insider of the debtor.

UNIF. FRAUDULENT TRANSFER ACT § 4(b).

[29] UNIF. FRAUDULENT CONVEYANCE ACT § 4, 7A U.L.A. 427 (1918).

[30] *Id.* § 7 (emphasis added).

[31] "Constructive" means it is a lie, but we choose to pretend it is true. *See* Robert Stevens, *When and Why Does Unjust Enrichment Justify the Recognition of Proprietary Rights?*, 92 B.U. L. REV. 919, 936 (2012) ("'[C]onstructive' may be thought to mean 'constructed' (i.e., made up) . . . .").

According to Kenneth C. Kettering, the reporter for the new Uniform Voidable Transactions Act ("UVTA"):

> The main purpose of the renaming is to replace the long-used but misleading word "fraudulent" with terminology that will not mislead.
>
> . . . .
>
> The heart of the matter is that fraud, in the modern sense of the word, is not, and never has been, a necessary element of a claim for relief under the [UFCA].[32]

Building on antiquarian comments by Professor Max Radin,[33] Kettering makes the startling claim that the term "fraudulent conveyance" stems from bad translation of the phrase *fraudem creditorum*.

> The confusion in terminology can be blamed on the fact that American lawyers, as a group, have never been fluent Latin scholars. The English common law of fraudulent conveyance, which long predated the Statute of 13 Elizabeth, drew on the well-developed Roman law on the subject. From that source the Latin expression in *fraudem creditorum* came to be familiar to the English legal community in Elizabethan times. Translated by the "if-it-were-English" method, that became the familiar phrase "in fraud of creditors." But the root word *fraus* did not really mean "fraud." Rather, it meant "prejudice" or "disadvantage." The key phrase "hinder, delay, or defraud any creditor" in the Statute of 13 Elizabeth, which remains the statement of the primordial rule in the UFTA and other modern statutes, was written by Elizabethan lawyers who were far better Latinists than today's, and the statutory phrase signals the correct understanding through its use of "hinder" and "delay" in addition to "defraud." But this point is too subtle to sink into the shorthand language used by lawyers in a hurry. A more correct shorthand for this doctrine than "fraudulent conveyance" or "fraudulent transfer" would be the more correct translation, "conduct to the prejudice of creditors."[34]

[32] Kettering, *supra* note 16, at 806 (noting the "change . . . is a mere shift in terminology that has no substantive effect" on the UFTA).
[33] *See generally* Radin, *supra* note 13, at 111 (commenting on the confusion and ambiguity in using the term "fraud," which has compelled the need to distinguish between "actual" fraud and "constructive" fraud).
[34] Kettering, *supra* note 16, at 807.

These comments are relevant to the Supreme Court's ruling that "actual fraud" in Bankruptcy Code section 523(a)(2) means receipt of a fraudulent transfer.[35] Perhaps the Supreme Court's reading of this language was fueled by bad Latin translation—though, to be sure, a bad translation sanctified by time. We are trying to determine what Congress meant by using the phrase "actual fraud." No canon of principle states that congressional intent must cohere with competent Latin translation.

We have said that, traditionally, an unsecured creditor without a judicial lien in *D*'s gold brick has no property interest in the brick. *D* owns all of the gold brick and *C* owns none of it.[36] But when *D* fraudulently transfers the brick to *X*, *C* gets some of the brick for the first time. Because *D* conveyed fraudulently to *X*, *C* and *X* are transferees of the brick. *C* is invited to step forward and establish a judicial lien on *X*'s gold brick.

Prior to securing that lien, *C*'s property has been compared to an unperfected security interest in *X*'s gold brick.[37] Thus, *X* can alienate the brick to a subsequent good faith transferee free and clear of *X*'s property interest,[38] including to a creditor of *D* or a creditor of *X*.[39] *C* can "perfect" its interest by actually getting a court order or judicial lien on *X*'s brick before any transferee of *X* appears on the scene.[40] These points justify the view that *C* has a weak property interest in the brick once *D* conveys it to *X*.

Before the fraudulent transfer, then, *C* has no *in rem* interest in *D*'s property. But a property interest definitely arises the very moment *D* fraudulently transfers the brick to *X*. The Supreme Court danced around these issues in *Grupo Mexicano de Desarrollo v. Alliance Bond Fund*.[41] There, the Court referred to "the rule that a general creditor could not interfere with the debtor's use of his property."[42] But it also speculated that the UFCA and UFTA changed that rule:

> Several States have adopted the [UFCA or UFTA], which has been interpreted as conferring a nonjudgment creditor the right to bring a fraudulent conveyance claim. Insofar as [Federal Rules of Civil

[35] *See* Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1590 (2016) (interpreting "actual fraud" in section 523(a)(2)(A) to encompass fraudulent conveyance schemes effectuated without false representation to a creditor).

[36] *See* Pusey & Jones Co. v. Hanssen, 261 U.S. 491, 497 (1923) (explaining an unsecured creditor has no right in the property of his debtor).

[37] *See* Julie Sirota Kourchin & Juli J. Kempner, Note, *Fraudulent Conveyance Law as a Property Right*, 9 CARDOZO L. REV. 843, 846–48 (1987) (analogizing unperfected security interest to liens and explaining that until a lien is perfected, it is vulnerable to subsequently created judicial liens, subsequently created security interests, where a subsequent secured party perfects first or a subsequent bona fide purchaser purchases for value).

[38] *Cf.* U.C.C. § 9-317(b) (2017) ("[A] buyer, other than a secured party . . . takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.").

[39] *Cf. id.*

[40] *See* Carlson, *Logical Structure*, *supra* note 19, at 176–77.

[41] 527 U.S. 308 (1999).

[42] *Id.* at 322.

> Procedure] Rule 18(b) applies to such an action, the state statute eliminating the need for a judgment may have altered the common-law rule that a general contract creditor has no interest in his debtor's property. Because this case does not involve a claim of fraudulent conveyance, we express no opinion on the point.[43]

Grupo Mexicano was a case barring prejudgment injunctions against a debtor's dissipation of assets, but the court demurred if a fraudulent transfer was about to occur.[44] At least under New York law, the question is very close as to whether *C* can, in advance, restrain *D*'s alienation of the brick.[45] Since injunctions imply property concepts,[46] it must be held as ambiguous whether *C* has a property interest in *D*'s gold brick before *D* fraudulently transfers it.[47]

II. WHAT FRAUDULENT TRANSFERS ARE NOT

A fraudulent transfer requires that *D* intend to convey *title* to *X*. *X*'s title is said to be voidable (as the UVTA loudly emphasizes).

This simple truth implies that in three situations *D* has not made a fraudulent transfer. Each of these situations was confounded with fraudulent transfers in the cases to be discussed.

A. Stolen Goods

We have defined fraudulent transfers, in part, as the voluntary conveyance of title from *D* to *X*. If the transfer is fraudulent, *C* has the remedy of avoidance against *X*.[48] Avoidance entails attachment of *C*'s judicial lien to *X*'s property.[49]

Suppose *D* owns a gold brick and *X* steals it. *X* has no title to the brick. *D* still has title. There has been no fraudulent transfer. Where *X* is a thief, *C* does not need an avoidance theory to get the brick. The brick is still *D*'s property. *C*'s writ of

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[43] *Id.* at 324 n.7 (citations omitted).

[44] *Id.* at 324.

[45] *See* David Gray Carlson, *Critique of Money Judgment (Part II: Judicial Liens on New York Personal Property)*, 83 ST. JOHN'S L. REV. 43, 182–90 (2009).

[46] A famous article reduces property to the availability of injunctive relief. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1105 (1972).

[47] *See* WESLEY NEWCOMB HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS AS APPLIED IN JUDICIAL REASONING AND OTHER LEGAL ESSAYS 68 (1923) ("The phrases *in personam* and *in rem*, in spite of the scope and the variety of the situations to which they are commonly applied, are more usually assumed . . . to be of unvarying meaning and free of ambiguities . . . . The exact opposite is, however, true . . . .").

[48] *See* UNIF. FRAUDULENT TRANSFER ACT § 7(a)(1) (1984) (stating in an action for relief against a transfer or obligation may obtain avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim).

[49] *See* Carlson, *Logical Structure*, *supra* note 19, at 166–68.

execution authorizes the sheriff to levy *D*'s property.[50] The sheriff can simply seize the brick from *X*.[51]

Theft is not an actual fraudulent transfer because *D* did not intend to transfer title in the first place. Indeed, title is not even transferred. Theft is not a constructive fraudulent transfer (even if *D* is insolvent) because there has been no conveyance or transfer *of title*. "The law distinguishes between a purchaser whose vendor obtained title by fraud and a purchaser whose vendor obtained title by theft, because an involuntary transfer results in a void title, whereas a voluntary transfer, even if fraudulent, renders the title merely voidable."[52] "[A] thief has no title in the property that he steals."[53]

Careful consideration reveals this must be so. Suppose *D* is a billionaire and *X* has purloined *D*'s gold brick. *D* is entitled to replevy the brick or may sue *D* in conversion. If we say that *D* has made a fraudulent transfer, we are also saying that *D* may not get the brick back, and that *X* is not a thief. These points should hold whether *D* is a billionaire or is insolvent.

B. Secured Transactions

Fraudulent transfer law invites *C* to obtain a judicial lien on *X*'s brick if *D* fraudulently transfers the brick to *X*. If, however, prior to the conveyance, *D* has granted a security interest to *C*, then fraudulent transfer theory is superfluous.

Suppose in a written agreement, *D* grants to *C* a security interest in a gold brick. Thereafter, *D* gives the brick to *X* for no reasonably equivalent value. *C* does not need an avoidance theory to take *X*'s brick. *C*'s security interest implies *C*'s right of possession (if *D* has defaulted under the *D-C* security agreement).[54] Indeed, Article 9 security interests prevent fraudulent transfers by giving to *C* a lien in advance of *D*'s actual conveyance of the brick to *X*. Secured creditors have absolutely no need for an unsecured creditor's avoidance remedy.[55]

C. Transfer of Trust Property

Suppose *C* (not D) owns the gold brick. By fraud, *D* induces *C* to transfer the brick to *D*. *D* then gives the brick to *X* for no consideration.

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[50] *See, e.g.*, N.Y. C.P.L.R. § 5232(b) (McKinney 2009).

[51] *See* GLENN, *supra* note 12, § 55, at 78 ("If the debtor has not succeeded in effecting any change in title under applicable rules of law, then he still has the asset, and this book must be laid aside.").

[52] CBS Recovery, Inc. v. Laxton, 600 F.3d 1138, 1145 (9th Cir. 2010).

[53] Kitchen v. Boyd (*In re* Newpower), 233 F.3d 922, 929 (6th Cir. 2000).

[54] *See* U.C.C. § 9-609(a) (2017) ("After default, a secured party (1) may take possession of the collateral . . . .").

[55] The UFTA even denies that the gold brick is an "asset." *See* UNIF. FRAUDULENT TRANSFER ACT § 1(2) (1984) ("'Asset' . . . does not include: (i) property to the extent it is encumbered by a valid lien . . . ."); *see also id.* § 1(13) ("'Valid lien' means a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.").

X has not received a fraudulent transfer.[56] A fraudulent transfer invites *C* to obtain a judicial lien on *X*'s brick. *C* has something better than that. *C* can impose upon *X* a constructive trust.

A constructive trust arises from unjust enrichment as a result of a transfer of title from *C* to *D*, where there is something wrong with the capacity of *C*. For example, *C* is an infant or is mentally incompetent.[57] Or, most familiarly, the transferor was induced by fraud to part with title. The defect attendant to the transfer goes by the name of unjust enrichment.[58] According to the Restatement (Third) of Restitution and Unjust Enrichment:

> If a defendant is unjustly enriched *by the acquisition of title* to identifiable property at the expense of the claimant of in violation of the claimant's rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.[59]

Because *C* was induced by fraud to part with title to the brick, *D* was the constructive trustee of the brick. Constructive trust is based upon the fact that, because of the fraudulent inducement, *C* could rescind the *C-D* transfer and regain title to the brick.[60] One says that *D* has voidable title in the brick, and *D* is the constructive trustee of it for the benefit of *C*—the *cestui que trust*.[61]

As a trustee, *D* is empowered to convey good title to a bona fide purchaser for value.[62] Where *X* paid no consideration (or where *X* paid for the brick with knowledge of *D*'s fraud), *X* takes only legal title to the brick. *C* remains the beneficiary of a trust. *X* inherits the duty to return the brick to *C*.

If the *D-X* conveyance was a fraudulent transfer, *C*'s property interest arises only when *D* delivers the brick to *C*. Here, where *D* held the brick in trust for *C*, *C*'s

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[56] *See* Stevenson v. J.C. Bradford & Co. (*In re* Cannon), 277 F.3d 838, 851 (6th Cir. 2002); *In re* Siverio, 253 F. Supp. 3d 418, 424 (Bankr. D.P.R. 2017). *See generally* David Gray Carlson, *Constructive Trusts and Fraudulent Transfers: When Worlds Collide*, 103 MARQ. L. REV. 365, 422–25 (2019) [hereinafter Carlson, *Constructive Trusts and Fraudulent Transfers*].

[57] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 16(2)(a)–(b) (AM. LAW INST. 2010).

[58] *See* Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. L. REV. 297, 299 (1989) ("Unjust enrichment is a broad concept: it refers to any case in which the defendant received a benefit that, for reason of fairness, he should not retain.").

[59] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55(1) (emphasis added).

[60] *See* Roscoe Pound, *The Progress of the Law, 1918-19 Equity*, HARV. L. REV. 420, 421 (1918) ("As the chancellor acted *in personam*, one of the most effective remedial expedients at his command was to treat a defendant as if he were a trustee and put pressure upon his person to compel him to act accordingly.").

[61] Properly, *C* in the above sentence is not a creditor. *D* cannot redeem the trust property by paying cash to *C*. Rather, *C* is a property owner entitled to possession. *See* Carlson, *Constructive Trusts and Fraudulent Transfers*, *supra* note 56, at 378–82.

[62] "In effect, the constructive trust claim is cut off because the bona fide purchaser has not been unjustly enriched." Sherwin, *supra* note 58, at 306 n.41.

equitable title precedes delivery of the brick to *X*.[63] Furthermore, under fraudulent transfer law, *C* can only get a judicial lien. That is, *C* must (via a court officer) sell the brick and return any surplus to *X*. But, where we have before us a constructive trust, *C* is entitled to replevy the brick and is entitled to possess it. There is no need to sell.

III. DISCHARGE OF DEBT

Our goal is to figure out, if possible, what the Supreme Court's opinion in *Husky International Electronics, Inc. v. Ritz*[64] means. This requires a brief look at discharge of debt.

Federal bankruptcy law provides for the discharge of debt.[65] Originally, this meant that a creditor, after discharge, could no longer enforce the debt.[66] Discharge was conceived as a defense to an action on a debt.[67] Being a defense, the discharge could be waived if it was not pleaded in an answer to a complaint.[68] The Federal Rules of Civil Procedure still so regard discharge.[69]

Discharge was thus similar to the statute of limitations defense. Not only did a debtor have to plead the defense of discharge, but a debtor's promise to pay (after discharge or after lapse of the statute of limitations) was enforceable because the moral obligation to pay served as "consideration" to support formation of the contract.[70]

In 1978, the concept of discharge changed dramatically. First, discharge was defined in Bankruptcy Code section 524(a) to mean the dissolution of any pre-petition

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[63] City Nat'l Bank v. Gen. Coffee Corp. (*In re* Gen. Coffee Corp.), 828 F.2d 699, 702 (11th Cir. 1987) ("[A] constructive trust arises when the facts giving rise to the fraud occur."), *cert. denied*, 485 U.S. 1007 (1988). There is controversy as to whether this is so. *Compare* Andrew Kull, *Restitution in Bankruptcy: Reclamation and Constructive Trust*, 72 AM. BANKR. L.J. 265, 267 (1998) (stating that a constructive trust precedes the declaration of it), *with* Sherwin, *supra* note 58, at 312 (describing a constructive trust as "an illusion").

[64] 136 S. Ct. 1581, 1590 (2016).

[65] *See* 11 U.S.C. § 1141(d)(1)(A) (2018) ("[T]he confirmation of a plan discharges the debtor from any debt that arose before the date of such confirmation."); *see also* Jonathon S. Byington, *Fiduciary Capacity and the Bankruptcy Discharge*, 24 AM. BANKR. INST. L. REV. 1, 3 (2016) (stating one of the primary purposes of bankruptcy law is to provide a debtor with a fresh start, accomplished in part by granting debtors a discharge of their debts).

[66] *See* Doug Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C. L. REV. 723, 729 (1980) ("Courts have recognized that the effect of a discharge in bankruptcy is to suspend a creditor's right of action to enforce the collection of his claim.") (citation omitted).

[67] *See* COLLIER ON BANKRUPTCY, ¶ 524.LH (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009) ("[T]he effect of a discharge was to create an affirmative defense that the debtor could plead in any action brought on the discharged debt.").

[68] *See id.* (explaining, if a debtor failed to affirmatively plead discharge, "the defense was deemed waived and an enforceable judgment could then be taken against him or her").

[69] *See* FED. R. CIV. P. 8(c)(1).

[70] *See* Horner v. Speed, 2 Pat. & H. 616, 617 (Va. S. Ct. 1857) ("A moral obligation to pay a debt is never stale, and may be the consideration for a new promise to pay an old debt at any distance of time after the discharge of the debt by bankruptcy.").

money judgment against *D*.[71] It also implied an injunction barring enforcement of any kind.[72] Any post-petition promise to pay a discharged debt was proclaimed unenforceable unless a court specifically approved a "reaffirmation agreement" whereby the discharge remedies were waived.[73] The injunctive nature of discharge implies that state courts (and federal diversity courts) do not even have the jurisdiction to decide whether a debt is discharged, since the very existence of the state action violates the discharge injunction.[74]

Discharge is designed to give *honest* debtors a fresh start in life following bankruptcy. Accordingly, certain bad acts result in the utter loss of any discharge.[75] Thus, concealing or falsifying financial records or perjury in the bankruptcy proceeding or failure to explain the disappearance of assets are among the bad acts that could lead a court to deny a discharge.[76] Pertinent here is Bankruptcy Code section 727(a)(2):

> (a) The court shall grant the debtor a discharge, unless—
> . . . .
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred . . . or has permitted to be transferred . . .
> (A) property of the debtor, within one year before the date of the filing of the petition; or
> (B) property of the estate, after the date of the filing of the petition . . . .[77]

The Federal Rules of Bankruptcy Procedure give a short deadline by which time a creditor or bankruptcy trustee[78] must file a complaint in an adversary proceeding denying the discharge.[79] In addition to the general loss of any discharge, certain individual claims are never dischargeable. Thus, Bankruptcy Code section 523(a) prohibits the discharges of most tax claims,[80] family law claims[81] and student loans.[82] Of concern to us are three different ideas from section 523(a).

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[71] 11 U.S.C. § 524(a)(1) (1982); *see also* Bankruptcy Reform Act of 1978, Pub. L. No. 95-989, 92 Stat. 2549 ("Subsection (a) specifies that a discharge in a bankruptcy case voids any judgment as to the extent that it is a determination of the personal liability of the debtor with respect to a prepetition debt.").
[72] *See* 11 U.S.C. § 524(a)(2), (3) (2018).
[73] *Id.* § 524(a)(c).
[74] *See* Benjamin Marguilis, Note, *The Bankruptcy Hegemon: Section 524(a) and its Effect on State and Federal Comity*, 31 CARDOZO L. REV. 905 (2010).
[75] *See* 11 U.S.C. § 727(a).
[76] *See id.*
[77] *Id.* § 727(a)(2).
[78] *Id.* § 727(a)(1).
[79] *See* FED. R. BANKR. P. 4004(a) ("In a chapter 7 case, a complaint . . . objecting to the debtor's discharge shall be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a).").
[80] 11 U.S.C. § 523(a)(1).
[81] *Id.* § 523(a)(5).
[82] *Id.* § 523(a)(8).

> (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, other than a statement respecting the debtor's or an insider's financial condition;
>
> . . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
>
> . . . .
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.][83]

These three nondischargeable claims are unified by the requirement in Bankruptcy Code section 523(c)(1), which states:

> [T]he debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debtor is owed, and after notice and a hearing, the court determines that such debt to be excepted from discharge under paragraph (2), (4), (6), as the case may be, of subsection (a) of this section.[84]

In other words, debts for money obtained by false pretenses, "actual fraud" or embezzlement are discharged, unless a creditor, within the time limit, files a complaint in an adversary proceeding to prevent the discharge from happening.

Chapter 13 entails a more extensive discharge than does chapter 7. Prior to 2005, the chapter 13 discharge was generous indeed.[85] But in its angry mood, Congress, in

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[83] *Id.* § 523(a).

[84] *Id.* § 523(c)(1).

[85] On the situation before 2005, see Susan Jenson-Conklin, *Nondischargeable debts in Chapter 13: "Fresh Start" or "Haven for Criminals"?*, 7 EMORY BANKR. DEV. J. 517, 535 (1990). According to one court:

> Perhaps many members of Congress thought that there would be a worthwhile purpose in permitting the discharge of debts under Chapter 13 not otherwise dischargeable under Chapter 7 when there would be a meaningful repayment program . . . This list of debtors would include embezzlers, murderers, rapists, forgers, thieves, arsonists and assorted other miscreants.

In re Chase, 28 B.R. 814, 819 n.3 (Bankr. D. Md. 1983), *rev'd*, 43 B.R. 738 (D. Md. 1984).

the Bankruptcy Abuse Prevention and Consumer Protection Act,[86] substantially narrowed the gap.[87] Today, chapter 13 discharges are not available for claims based on "actual fraud"[88] and embezzlement,[89] but a discharge is still available for claims based willful and malicious injury of property.[90]

Therefore, it makes a substantive difference if a court confuses a fraudulent transfer under section 523(a)(2) with a conversion cause of action. Provided a conversion claim is not also a claim arising from actual fraud or embezzlement, a chapter 13 discharge extends to the conversion cause of action, but not to a claim based on actual fraud.

IV. PRIOR TO *HUSKY*

The Supreme Court thinks that its job is to settle "circuit splits"—disagreements between the Courts of Appeals as to what federal law is.[91] Therefore, we visit the circuit split that gave rise to *Husky*, where we shall find some surprises. I examine two opinions that agree "actual fraud," as that term is used in Bankruptcy Code section 523(a)(2), includes the receipt of fraudulent transfers. Then, we look at the lower court opinions in *Husky*, which engendered the split.

A. McClellan

The first court of appeals opinion in the eventual circuit split was *McClellan v. Cantrell*.[92] Ironically, the case did not involve a fraudulent transfer.

In *McClellan*, *C* sold machinery to *D Corp.* on secured credit. That is to say, *C* had a purchase-money security interest on equipment. *C*, however, neglected to perfect the security interest. *D Corp.* sold its equity interest in the machinery to *X* (a bad faith purchaser) for nominal consideration. *X* sold the machinery for $160,000 to *Y* (whom I will presume to be a good faith purchaser). This was more than enough cash to retire *C*'s $100,000 claim against *D Corp. X* did not forward these cash proceeds to *C*.[93]

In a fraudulent transfer (where *D* conveys property to *X*), *C* obtains a property interest in *X*'s property exactly when *X* receives the transfer. *C* is then invited to

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86 *See* Pub. L. No. 109-8, 119 Stat. 23 (2005).

87 *See* Eugene R. Wedoff, *Major Consumer Bankruptcy Effects of BAPCPA*, 2007 U. ILL. L. REV. 31, 62–63 (2007).

88 11 U.S.C. § 523(a)(2).

89 *Id.* § 523(a)(4).

90 *Id.* § 523(a)(6). Subsection (a)(6) is not included in the now-lengthy list of exclusions in section 1328(a)(2). A separate provision bars a chapter 13 discharge for claims involving willful and malicious injury to the person of an individual. *Id.* § 1328(a)(4).

91 SUP. CT. R. 10 (providing "[a] petition for a writ of certiorari will be granted only for compelling reasons" and listing one of those reasons as when "a United States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter").

92 217 F.3d 890 (7th Cir. 2000).

93 *Id.* at 892 (*C* was "not telling anyone what ha[d] happened to that money").

perfect this interest by obtaining a judicial lien on *X*'s property. In *McClellan*, however, *C* already was a secured creditor. *C* had a consensual purchase-money security interest in the machinery and did not need an avoidance theory to recover against *X*. Rather *X*, a bad faith buyer, obtained title subject to *C*'s security interest.[94]

When *X* sold to *Y* (whom we presume to be in good faith), *Y* bought free of *C*'s security interest.[95] Sale by *X* constituted a conversion of *C*'s property.[96] *C* thus became a creditor of *X*.

X subsequently filed for bankruptcy. Properly, by selling the encumbered machinery to *Y*, *X* willfully and maliciously injured *C*'s property by converting it to her own use.[97] Accordingly, *C*'s claim against *X* was not dischargeable under section 523(a)(6).[98] The case definitely did not entail a fraudulent transfer, as the district court more or less recognized.[99]

On appeal, however, Judge Posner uncharacteristically committed serious analytical errors. First, he treated *D* (*D Corp*.'s shareholder) as the owner of the machinery. To understand his reasoning, we will sometimes follow this error and refer to *D* (not *D Corp*.) as transferee. Second, Judge Posner assumed he had before him a fraudulent transfer case, not a conversion case,[100] *C* was seen as a creditor of *X* because *D Corp.* fraudulently transferred the machine to *X*. As Judge Posner put the matter:

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[94] U.C.C. § 9-315(a)(1) (2017) ("Except as otherwise provided in this article . . . (1) a security interest . . . continues in collateral notwithstanding sale."); *see McClellan*, 217 F.3d at 898 (Ripple, J., concurring).

[95] U.C.C. § 9-317(b). Judge Ripple, in a concurring opinion, claims that by selling to *Y*, *X* willfully injured *C*'s property because *C*'s security interest was destroyed. *McClellan*, 217 F.3d at 897 (Ripple, J., concurring). Therefore, nondischargeability was properly established by Bankruptcy Code section 523(a)(6). *See id.* But this overlooks the fact that *X* took back cash proceeds from *Y* to which *C*'s security interest attached.

[96] Teddy's Drive-In, Inc. v. Cohen, 390 N.E.2d 290, 291 (N.Y. 1979).

[97] *See* RESTATEMENT (SECOND) OF TORTS § 222A (AM. LAW INST. 1965) (defining conversion as an "intentional exercise of dominion or control over a chattel").

[98] *See* 11 U.S.C. § 523(a)(6) (providing for the nondischargeability of any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity"); Friendly Fin. Serv. Mid-City, Inc. v. Modicue (*In re* Modicue), 962 F.2d 452, 453 (5th Cir. 1991). Willful and malicious conversion was basically the theory in Judge Ripple's concurring opinion in *McClellan*. For a review of the jurisprudence of section 523(a)(6) and conversion of Article 9 collateral, see Charles Jordan Tabb, *Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 68, 113 (1990). Professor Tabb concludes that, in a majority of conversion cases, the converting debtor was found neither willful nor malicious and so achieved discharge after all. *See id.*

[99] The district court ruled that *C* "does not have a valid claim under the UFTA against [*X*]." *In re* Cantrell, No. 99 CV 5061, 1999 U.S. Dist. LEXIS 16486, at *10 (N.D. Ill. Oct. 13, 1999). Its reasoning, however, is inscrutable. Apparently, looking ahead to the issue of Bankruptcy Code section 523(a)(2), the court seemed to assume that *C* must show that *X* had the bad intent of a transferor. *X*, however, was a transferee. "Any fraudulent activity in which [*X*] have engaged was not fraudulent 'as to a creditor,' as required by the [UFTA] . . . . It therefore appears that, *as to [X]*, the transfer falls outside the plain language of the UFTA." *Id*. Of course, if *X* received a fraudulent transfer, *C is* a creditor of *X*, because the UFTA renders *X* liable in the *in personam* sense for having received a fraudulent transfer. *See* UNIF. FRAUDULENT TRANSFER ACT § 8(b)(1) (1984).

[100] For a similar error, see DZ Bank AG Deutsche Zentral-Genossenschaftsbank v. Meyer, 869 F.3d 839 (9th Cir. 2017). In *Meyer*, *SP* claimed a security interest in *D Corp*. assets. *D* (shareholder of *D Corp*.) stole *SP*'s collateral. The court treated the crime as a fraudulent transfer from *D Corp*. to *D* and exempted *SP*'s claim against *D* from discharge under section 523(a)(2). Properly *D* fell under the jurisdiction of section 523(a)(6).

> The two-step routine that [*C*] alleges and that we must take as true—in which [*D Corp.*] transfers valuable property to [*X*] for nothing in order to keep it out of the hands of [*C*] and [*X*] then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with [*D Corp.*] to defeat the rights of [*A*'s] creditor—is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud.[101]

In fact, the function of fraudulent transfer law is to supply creditors, such as *C*, with a judicial lien on third-party property.[102] Since *C* already had a security interest pursuant to Article 9, *C* did not need to rely on an "avoidance" theory. Rather, *C*'s claim against *X* sounded in conversion and was itself nondischargeable under Bankruptcy Code section 523(a)(6).

Let us waive this point, however. Assume that *D Corp.*'s conveyance of the machinery to *X* was a fraudulent transfer. *C*'s in personam claim against *X* arose under UFTA section 7(b):

> [T]o the extent a transfer is voidable in an action by a creditor under Section 7(a)(1), [*C*] may recover a judgment for the value of the asset transfer, as adjusted under subsection (c), or the amount necessary to satisfy the creditor's claim, whichever is less. The judgment may be entered against:
>
> (1) the first transferee of the asset . . . .[103]

In *X*'s chapter 7 bankruptcy, *C* filed a complaint to exempt the section 7(b) claim from discharge, citing section 523(a)(2), which punishes receipt of property in connection with actual fraud. The lower courts had ruled that section 523(a)(2) applies only to obtaining property through misrepresentations, not through acts of raw power by *D* to convey assets in order to hinder creditors. On appeal, Judge Posner accused the lower courts of confusing the familiar with the necessary. Most uses of section 523(a)(2) involve affirmative misrepresentations. But "actual fraud" comprehends intentional transfers by *D Corp.* to *X*.

In particular, Judge Posner took umbrage at the district court's remark that "the Supreme Court recently scoffed at the idea that a debt could be nondischargeable under the fraud exception of section 523(a)(2)(A) without a showing of material

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[101] McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000).

[102] *See* 11 U.S.C. § 548(c) ("[A] transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or oblige gave value to the debtor.").

[103] UNIF. FRAUDULENT TRANSFER ACT § 7(b).

misrepresentation and reliance on the statement."[104] The district court was referring to *Field v. Mans*,[105] which deserves a quick detour.

In *Field*, *D* was the sole shareholder of *D Corp*. *D Corp*. bought real property from *C* on credit, with *D Corp*. conveying back a mortgage to *C*. The mortgage agreement had a "due on sale" clause: *D Corp*.'s sale of the real property would constitute a default on the mortgage. Unbeknownst to *C*, *D Corp*. sold the land, thereby triggering a default. *D* contacted *C* after the fact and requested a waiver of the default clause. *C* offered to waive default for too high a price. *D* refused to pay. *D* did not disclose *D Corp*.'s conveyance. *D* filed for bankruptcy. *C* discovered *D Corp*.'s sale of the real property. *C* therefore accelerated *D Corp*.'s loan. In a complaint to bar *D*'s discharge of his guaranty obligation, *C* claimed *D* defrauded *C* and that this barred discharge under Bankruptcy Code section 523(a)(2).

Now there is a lot wrong with *C*'s claim. Bankruptcy Code section 523(a) requires that the debt arise from property obtained by "false pretenses, a false representation, or actual fraud."[106] It is hard to see how *D* obtained any property because *D Corp*. sold real estate to some buyer. Furthermore, *C* still had its mortgage, which was enforceable against the buyer. It is hard to fathom that *C* was even injured.[107]

The bankruptcy court found that *D*'s communications with *C* constituted a false representation. But the court refused to exempt *D*'s guaranty obligation from discharge because *C* could have checked the real estate records and could have discovered the conveyance by *D Corp*. Because *C* had not acted reasonably, *C* could not show "reasonable reliance" on the misrepresentations. "Reasonable reliance" is a phrase that appears in section 523(a)(2)(B)(iii),[108] which requires a written statement. The phrase does not appear in section 523(a)(2)(A).

In his opinion, Justice Souter rejected the idea that since section 523(a)(2)(b)(iii) requires reasonable reliance, section 523(a)(2)(A) has no reliance requirement at all-that completely immaterial misstatements could trigger nondischargeability. "[C]ommon sense would balk," wrote Justice Souter.[109] Thus, reliance *is* an element of section 523(a)(2)(a). But what kind? "[W]e will look to the concept of 'actual fraud,' as it was understood in 1978 when that language was added to section 523(a)(2)(A)."[110] The understanding of 1978, Justice Souter thought, was embodied

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[104] *McClellan*, 217 F.3d at 893.

[105] 516 U.S. 59, 70 (1995).

[106] 11 U.S.C. § 532(a)(2)(A) (2018).

[107] Justice Ginsburg raised these concerns in her concurring opinion. *Field*, 516 U.S. at 78–79 (Ginsburg, J., concurring). Justice Breyer could see no difference between "justifiable" and "reasonable" and thought *D* should be discharged. *Id.* at 80–82 (Breyer, J., dissenting). A contrary opinion occurs in *Vulcan Coals, Inc. v. Howard*, 946 F.2d 1226 (6th Cir. 1991), where *D Corp*. granted a mortgage to *C* and *C* did not record. *D* (shareholder of *D Corp*.) had guaranteed the mortgage debt of *D Corp*. Because *D* participated in *D Corp*.'s transfer of the real property to a bona fide purchaser for value free and clear of the mortgage, *C* could block *D*'s discharge on the guaranty under section 526(a)(6). The result depends on an unarticulated piercing of the corporate veil of *D Corp*.

[108] 11 U.S.C. § 523(a)(2)(B)(iii) (containing the phrase "reasonably relied").

[109] *Field*, 516 U.S. at 68 (footnote omitted).

[110] *Id.* at 70 (footnote omitted).

in the Restatement (Second) of Torts. The Restatement requires *justified* reliance. So "actual fraud" requires justified reliance.[111]

Justified reliance is precisely absent in the case of fraudulent transfers, where *D* has the pure power to put her property out of the reach of a creditor's writ of execution. As to *Field*, Judge Posner commented:

> Actually *Field* has nothing to do with this case. The fraud there took the form of a misrepresentation, and the only issue was the nature of the reliance that a plaintiff must show in such a case. Nothing in the Supreme Court's opinion suggests that misrepresentation is the only type of fraud that can give rise to a debt that is not dischargeable under section 523(a)(2)(a).[112]

While I do not disagree with Judge Posner's interpretation of *Field*, the Supreme Court has only itself to blame for being misread, in that Justice Souter does find justifiable reliance to be at the very heart of "actual fraud." Nevertheless, recall Professor Kettering's point that "actual fraud" is a bad translation for the Latin phrase *fraudem creditorum*.[113] A fraudulent transfer is really an "inconvenient transfer" from the perspective of the creditors—not a "fraud" at all. Be that as it may, the issue is: what Congress means by "actual fraud" in section 523(a)(2)? Congress could well have meant the bad Latin translation, in common with most commercial lawyers in 1571 and now.

As applied to *McClellan* (treated as a fraudulent transfer case), Bankruptcy Code section 523(a)(2)(A) indicates that *X* is liable to *C* for obtaining property from *D* by actual fraud. Actual fraud means *D*'s intent to hinder, delay or defraud *C*. *X*'s intent is not part of *C*'s cause of action. The intent we care about is that of *D*. But, when it comes to section 523(a)(2) and actual fraud, Judge Posner ruled that we should also concern ourselves with *X*'s intent. Thus, *D Corp.* and *X* must *collude*.[114] *D Corp.*'s intent still matters. Gratuitous transfers with no bad intent by *D Corp.* are not "actual"

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[111] According to Justice Souter:

> The Restatement expounds upon justifiable reliance by explaining that a person is justified in relying on a representation of fact "although he might have ascertained the falsity of the representation had he made an investigation." Significantly for our purposes, the illustration is given of a seller of land who says it is free of encumbrances; according to the Restatement a buyer's reliance on this factual is justifiable, even if he could have "walked across the street to the office of the register of deeds in the courthouse" and easily have learned of an unsatisfied mortgage.

Id. (citing RESTATEMENT (SECOND) OF TORTS §§ 540, 540 illus. 1 (AM. LAW INST. 1976)).

[112] *McClellan*, 217 F.3d at 892; *accord*, David. F. Snow, *The Dischargeability of Credit Card Debt: New Developments and the Need for a New Direction*, 72 AM. BANKR. L.J. 63, 99 (1998) ("[A]ctual fraud is broader than misrepresentation.").

[113] *See supra* text accompanying notes 34–35.

[114] *McClellan*, 217 F.3d at 893.

frauds, no matter what *X*'s state of mind was.[115] But now we must consider *X*'s state of mind:

> And so in this case, if though [*D Corp.*] intended to thwart [*C*] and was thus committing actual fraud, [*X*] was innocent--if she had no intention of hindering any creditor--the debt that [*C*] is seeking to collect from her would not have been obtained *by her* by actual fraud. But she is alleged to have been a full and equal participant in [*D Corp.*'s] fraud, to have been in effect his accomplice . . . The debt that [*C*] is seeking to collect from her (and prevent her from discharging) arises by operation of law *from her fraud*. That debt arose not when [*D Corp.*] borrowed money [sic] from [*C*] but when she prevented [*C*] from collecting from [*D Corp.*] the money [*D Corp.*] owed him.[116]

Judge Posner went further to suggest that if *D* (shareholder of *D Corp.*) were bankrupt, *C* would have a fraudulent transfer claim against *D*,[117] and if this were an "actual fraud," *C*'s claim against *D* would not be dischargeable in *D*'s bankruptcy. But this is patently not so. First, the UFTA authorizes money judgments against "the first transferee of the asset or the person for whose benefit the transfer was made"[118] or "any subsequently transferee other than a good faith transferee who took for value or from any subsequent transferee."[119] Judgments against the transferor are not mentioned.[120] Second, section 523(a)(2) requires that the debt arise from property *obtained* by actual fraud. *D* has not *obtained* property. Quite the opposite. He has *disobtained* property, as it were, by giving the machinery away.

Speaking of *X*'s loss of discharge, Judge Posner wrote:

> This result would be paradoxical if it meant that while [*X*] could not discharge her fraud debt in bankruptcy, [*D*] could have discharged the same debt had he declared bankruptcy. It does not mean this. What is true is that if [*D*] had merely defaulted on his original debt to [*C*], which so far appears was not created by a fraud, and later declared bankruptcy, that debt would have been dischargeable. If,

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115 *Id*. at 894 ("The fraud exception to the dischargeability of debts in bankruptcy does not reach constructive frauds, only actual ones, but the allegation here is that the transfer involved an *actual* fraud; [*D*] was deliberately attempting to thwart [*C*'s] effort to collect the debt due him.").

116 *Id.* at 894–95. *D Corp*. did not borrow money from *C*. Rather, *D Corp*. sold equipment on purchase-money credit.

117 *Id.* This would also require a piercing of the corporate veil. Judge Posner confuses the personhood of *D Corp*. and *D*.

118 UNIF. FRAUDULENT TRANSFER ACT § 8(b)(1) (1984).

119 *Id.* § 8(b)(2).

120 Justice Sotomayor also commits this analytical error. Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1587 (2016) ("Relatedly, under the Statute of 13 Elizabeth and the laws that followed, both the debtor and the recipient of the conveyed assets were liable for fraud . . . .").

> however, he had rendered the debt uncollectible by making an actually fraudulent conveyance of the property that secured it, his actual fraud would give rise to a new debt, nondischargeable because created by fraud. But it would be a new debt only to the extent of the value of the security that he conveyed, for that would be the only debt created by the fraud itself. For example, if [*D*] owed [*C*] $100,000 and defaulted after having transferred to [*X*] property securing the debt worth $10,000, he would be entitled to discharge $90,000 of the debt, for only the $10,000 was a debt created by fraud.[121]

This attempt to avoid the anomaly, however, does not succeed. Section 523(a)(2)(A) requires a debtor to "obtain property." Where *D* has *made* (not received) a fraudulent transfer, section 523(a)(2)(A) simply does not apply to *D*.

Thus, we are left with this situation: If *D* makes an "actual" fraudulent transfer within a year of bankruptcy, section 727(a)(2) applies to bar *D* from any discharge. But where *D* makes a fraudulent transfer thirteen months before bankruptcy and *X* knows of *D*'s bad intent, *D* obtains the discharge, but *X* does not. The paradox Judge Posner feared cannot be avoided.

Section 523(a)(2)(A) bars discharge for debts arising from *X*'s obtainment of property. Judge Posner worries about the fact that *X* has not obtained property *from C*. The statute, he observes, required free-form obtainment, not obtainment from the transferor. That is, *D* conveyed to *X*, and *C*'s fraudulent transfer claim came into existence at that time. On this point Judge Posner is right.[122] But he forgets about obtainment when it comes to *D*'s liability to *C* for fraudulent transfer.

Free-form obtainment ends up being a crucial point in the interpretation of Bankruptcy Code section 523(a)(2)(A), if indeed "actual fraud" comprehends *D*'s fraudulent transfers to *X*. Suppose *C* has an unsecured claim against *D* and *D* owns a gold brick. *C* has no property interest in the brick, on the traditional way of viewing the matter. Now suppose *D* conveys the brick to *X* in an actual fraudulent transfer. *X* obtains property from *D* (not from *C*). In fact, *C* is a *transferee*. *C* obtains property for the first time when *D* conveys to *X*. *D* conveys some of the brick to *C* (and the other unsecured creditors of *D*). *D* conveys the surplus only to *X* (if any). *C* does not *lose* property to *X*. *C gains* property from *D*. Ironically, *C* has property "obtained by" *D*'s fraud on *C*. Thus, if section 523(a)(2)(A) is to accommodate *D*'s fraudulent transfers, "obtain by" must be read in a free-form way.

In pursuit of this point, Judge Posner wrote:

> Another feature of the case, however, may seem to tell against our interpretation of section 523(a)(2)(A). We have been speaking of the nondischargeability of a debt that is created by fraud, but the actual

[121] *McClellan*, 217 F.3d at 895.
[122] *See id.* at 894–95.

> language of the statutes "any debt . . . for money, property, [or] services . . . to the extent obtained by . . . actual fraud." The words "obtained by" go with "money, property, [or] services," not with "debt." A debt is not something you obtain; it is something you incur as a consequence of having obtained money or something else of value from another person (the creditor). [*X*] obtained, for $10, machinery that she was able to sell of $160,000. It is true that she didn't obtain this money by a fraud *against* [*D*]. They were acting in cahoots. But the statute does not require that the transferor be the victim of the fraud, but only that the money, property, or services be obtained by fraud, and but for fraud [*X*] would not have obtained a $160,000 windfall [sic]. What is more, the property, the machinery, was not really [*D*'s] to give away; he was not the equitable owner; equity would have imposed a constructive trust for [*C*]'s benefit on the machinery wrongfully conveyed by [*D*]. Stated differently, [*D*] gave [*X*] [*C*'s] security interest. [*C*]'s property, which means that she was taking property from—defrauding—[*C*] directly.[123]

There are perplexing moments in this passage. Judge Posner claims that *C* was entitled to a constructive trust on the machinery. Presumably, he meant to say, "equitable lien," since the machinery was worth $160,000 and *C* claimed only $100,000. A constructive trust implies *X*'s duty to hand the machine over to *C* for *C* to keep. Surely *C* is limited to foreclosing a lien. Therefore, *X*'s windfall is not $160,000 but only $100,000. Second, a constructive trust (or equitable lien) is not appropriate. Such a remedy requires that *C* convey the machine in a rescindable transaction. But *C* (who *retained* a purchase-money security interest and conveyed only debtor equity to *D Corp.*) has no grounds for rescission. In addition, calling an unperfected secured party like *C* the beneficiary of a constructive trust implies that if *X* had not sold the machine and if *X* had filed for bankruptcy, *C*'s unperfected security interest would be valid against *X*'s bankruptcy trustee.[124] Confounding unperfected secured creditors with constructive trusts or equitable lien holders profoundly interrupts the Article 9 regulatory scheme. Finally, *D Corp.* did not give *X C*'s security interest. *X* (a bad faith purchaser) took *subject to C*'s security interest. *D Corp.* gave *D Corp.*'s equity to *X* (which *was D Corp.*'s to give).

Finally, note should be taken of the contradiction in the last sentence of the quoted passage. There, Judge Posner states that *C* (via *D*) transferred *C*'s property to *X*—*C*'s security interest. This is not only inaccurate, but it undercuts the assumption that the case involved a fraudulent transfer. In a fraudulent transfer, *C*'s property interest in the machine arises for the first time when *D* fraudulently transfers to *X*.

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[123] *Id.* at 895 (citations omitted).

[124] *See* City Nat'l Bank v. Gen. Coffee Corp. (*In re* Gen. Coffee Corp.), 828 F.2d 699, 701–04 (11th Cir. 1987).

Where *C*'s lien precedes *D*'s transfer to *X*, we do not have before us a fraudulent transfer.

Putting aside these imprecisions, Judge Posner ruled that *C* need not be a transferor to *X*. *C* can prevent *X*'s discharge where *D Corp.*, with actual intent to hinder *C*, fradulently conveys property to *X*. *D*'s bad intent is a necessary condition in finding that "actual fraud" encompasses *D*'s conveyances to *X*. But I remind the reader that *McClellan* was not a fraudulent transfer case in the first place, and that everything Judge Posner writes is analytically defective.

In *McClellan*, Judge Posner required *C* to show an extra element not actually required by state fraudulent transfer law—bad intent by *X*. In so ruling, Judge Posner was supported by an ancient Supreme Court opinion, *Neal v. Clark*.[125] In *Neal*, an executor of an estate sought to borrow funds on security of the estate. The bond the executor sold to *X* was over-discounted, and, on top of that, the executor made off with the proceeds of the bond. An insurance company that had covered the beneficiaries' loss sought to hold *X* liable for *devastavit*—looting of the decedent's estate. Thus, *X* had *received* money from the estate. The theory against *X* seemed to be that *X* paid too little for the bond. In effect, *X* was accused of receiving money for no reasonably equivalent value. To be sure, this was no fraudulent transfer case. The claim was that the executor had breached a fiduciary duty to the estate by giving away assets for insufficient value. The harm was to the decedent's estate, not creditors of the decedent estate.

X had filed for bankruptcy under the Bankruptcy Act of 1867. *X* therefore pleaded his bankruptcy discharge as a defense to the insurance company's action. The Virginia state trial court denied the defense, citing section 33 of the Bankruptcy Act, which stated that "no debt created by the fraud . . . of the bankrupt"[126] could be discharged. The highest court in Virginia agreed, characterizing *X* as guilty of constructive fraud, not actual fraud. According to Justice Harlan:

> We concur in the view expressed by the State court, that Neal was not guilty of actual fraud. The evidence does not show that he entertained any purpose himself to commit a fraud, or to aid the executor in committing one. The fair inference from all the testimony is that he purchased the bonds in good faith, not doubting the power or the right of the executor to sell, and having no reason to believe that he meditated any wrong to those interested in the estate which he was administering.[127]

Though clearly doubting that *X* was in any way liable, Justice Harlan said he was constrained to accept the state court's ruling that *X* was a transferee a constructive fraud. But he ruled that the Bankruptcy Act discharged liabilities for constructive

[125] 95 U.S. 704 (1877).
[126] *Id.* at 706.
[127] *Id.* at 707.

fraud, and that Congress intended "fraud" to mean *actual* fraud.[128] To be noted is the fact that Justice Harlan required the insurance company to show that *X* was guilty of moral turpitude, just as Judge Posner did. This the insurance company could not do.

To summarize, Judge Posner erred in assuming that *X* was liable to *C* under UFTA section 7(a). But if we waive this error, Judge Posner was plausibly correct that *C*'s claim against *X* was not dischargeable even though *C* never conveyed property to *X*. It is enough that *X* obtained property and *C*'s claim arose from that obtainment.

B. Lawson

The second case to contribute to the circuit split was *Sauer Inc. v. Lawson (In re Lawson)*.[129] Unlike *McClellan*, *Lawson* was a genuine fraudulent transfer case. But *C*, creditor of *D*, sought to bar *X*'s discharge for receipt of a fraudulent transfer when *C* did not properly own the fraudulent transfer claim. Rather, when *D* filed for bankruptcy, *C*'s cause of action under the Massachusetts UFTA was expropriated by *D*'s bankruptcy trustee,[130] Under Bankruptcy Code section 544(b)(1), the trustee is subrogated to the avoidance rights of creditors like *C*.[131] Thus, *D*'s bankruptcy trustee owned the cause of action and *C* did not.

In *Lawson*, *C* obtained a money judgment against *D* "asserting claims including fraud."[132] Thereafter, *D* transferred $100,000 to *X Corp.* (whose only shareholder was *X*). *D* filed for bankruptcy and *C* initiated an adversary proceeding objecting to *D*'s discharge. *D* defaulted in the adversary proceeding, so that *C*'s claim against *D* was held nondischargeable. Presumably, *C*'s complaint against *D* was founded upon some fraud or misrepresentation in connection with *C*'s money judgment against *D*. In other words, *D* must have defrauded *C* into parting with money or property, triggering nondischargeability under Bankruptcy Code section 523(a)(2)(A).

Meanwhile, the Rhode Island Superior Court found that *D*'s transfer to *X Corp*. was a fraudulent transfer as regards *C*. How this could be is a mystery. *D* was in bankruptcy by that time, and *C*'s continuation of the fraudulent transfer litigation

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[128] *Id.* at 709.

[129] 791 F.3d 214 (1st Cir. 2015), *cert. denied*, 136 S. Ct. 2443 (2016).

[130] Deutsche Bank Tr. Co. Ams. v. Large Private Beneficial Owners (*In re* Tribune Co. Fraudulent Conveyance Litig.), 818 F.3d 98, 111 (2d Cir. 2016); *In re* Tessmer, 329 B.R. 776, 779–80 (Bankr. M.D. Ga. 2005); *see* Kourchin & Kempner, *supra* note 37, at 848–55 ("[U]nder the Bankruptcy Code, *C*'s in rem right to pursue X's property is expropriated by the trustee."); Carlton v. Baww, Inc., 751 F.2d 781, 785 (5th Cir. 1985) ("Bankruptcy did not forever . . . extinguish the right to recover property that [*D*] may have fraudulently conveyed. Bankruptcy simply caused that right to vest in the trustee . . . ."). This rule goes back at least as far as *Glenny v. Langdon*, 98 U.S. 20 (1878).

[131] 11 U.S.C. § 544 (b)(1) (2018).

[132] *In re* Lawson, 505 B.R. 117, 119 (Bankr. D.R.I. 2014), *vacated*, 791 F. 3d 214 (1st Cir. 2015).

constituted a violation of the automatic stay.[133] It is usually said that acts in violation of the automatic stay are void.[134]

Be that as it may, in Rhode Island Superior Court, *C* obtained a writ of execution against *X Corp*. Thereafter, *X* caused *X Corp*. to convey $80,000 to *X*. The superior court ruled that the transfer from *X Corp*. to *X* was a fraudulent transfer into the hands of *X*, but this was unlikely to be so. *X Corp*. never had equitable title to the funds (only legal title). These funds were held in trust for the creditors of *D*.[135] Therefore, *C* properly had no claim that *X Corp*. made a fraudulent transfer to *X*.

On the other hand, the transfer from *X Corp*. to *X* consisted of *proceeds* of the fraudulent transfer from *D* to *X Corp*. Thus, *X* was a transferee of a transferee of *D*'s fraudulent transfer. UFTA section 7(b) directly authorizes *C* to pursue proceeds of *D*'s fraudulent transfer.[136] Since *X* was a gratuitous remote transferee and, in any case, had knowledge of the fraud, *X* had no defense to the claim of fraudulent transfer. But this claim did not belong to *C*, rather, it belonged to *D*'s bankruptcy trustee.[137]

Furthermore, since *D* was a chapter 13 debtor and since *D* had a confirmed plan, all property of the estate vested in *D*. The surprising result is that the cause of action against *X* was inherited by *D* from the chapter 13 trustee; *C* had no title to it.[138]

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[133] *See* Am. Nat'l Bank v. MortgageAmerica Corp. (*In re* MortgageAmerica Corp.), 714 F.2d 1266, 1277 (5th Cir. 1983).

[134] *See* David Gray Carlson, *Bankruptcy's Acephalous Moment: Postpetition Transfers Under the Bankruptcy Code*, 21 EMORY BANKR. DEV. J. 113, 128–31 (2004). Perhaps this was a point only *D*'s bankruptcy trustee could make before the Rhode Island court. *X* was denied the right to make such a claim in *Connell v. Walker*, 291 U.S. 1 (1934).

[135] *In re* Mill Concepts Corp., 123 B.R. 938, 944 (Bankr. D. Mass. 1991).

[136] *See* UNIF. FRAUDULENT TRANSFER ACT § 7(b) (1984).

[137] *In re* Crivaro, No. 15-23020 (JNP), 2017 Bankr. LEXIS 1133, at *12–13 (Bankr. D.N.J. Apr. 27, 2017), *aff'd*, 2018 U.S. Dist. LEXIS 56282 (Apr. 2, 2018).

[138] *See* 11 U.S.C. § 1327(b) (2018) ("[T]he confirmation of a plan vests all of the property of the estate in the debtor."). Adding to the complexity is the fact that *X* had filed for bankruptcy under chapter 13. *X*'s bankruptcy trustee is a hypothetical judicial lien creditor under Bankruptcy Code section 544(a):

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee, the rights and powers of . . .
>
> (1) a creditor . . . that obtains, at [the time of *X*'s bankruptcy petition], a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such creditor exists . . . .

Id. § 544(a)(1). Therefore, *X*'s bankruptcy trustee was a transferee of a transferee of the fraudulent transfer proceeds. Under the Bankruptcy Code, *X*'s bankruptcy trustee takes any traceable fraudulent transfer proceeds free and clear of *D*'s bankruptcy trustee. *See id.* § 550(b)(1). Nevertheless, *D*'s bankruptcy trustee could have pursued an unsecured claim against *X* in *X*'s bankruptcy because *X* was a transferee of a transferee of *D*'s fraudulent transfer. But this cause of action passes to *D* by virtue of confirmation of the chapter 13 plan. *See In re* Herbst, 76 B.R. 882, 884 (Bankr. D. Mass. 1987) (if *C* were to prevail in action against *X*, the avails would belong to *D*'s chapter 13 estate). My view of the meaning of chapter 13 will strike some as scandalous. Nevertheless, I stick by it. *See* David Gray Carlson, *The Chapter 13 Estate and Its Discontents*, 17 AM. BANKR. INST. L. REV. 233 (2009). *But see* Merritt v. Cheshire Land Pres. Tr. (*In re* Merritt), 711 F. App'x 83, 88 (3d Cir. 2017) (finding the post-confirmation debtor lacked standing to bring a fraudulent transfer action where chapter 13 trustee failed to sue).

Nevertheless, *C* claimed a judgment against *X*—one that should have been held void for violating the automatic stay. In *X*'s bankruptcy, *C* sought an exception from discharge for this judgment on the ground that *X* had obtained property by actual fraud in violation of Bankruptcy Code section 523(a)(2)(A). The district court ruled, however, that the judgment of *C* was dischargeable.[139]

The First Circuit Court of Appeals reversed. It quoted *Field v. Mans*,[140] holding that "actual fraud" means whatever the Restatement (Second) of Torts says it means.[141] The First Circuit stated, "[t]he comments to the relevant restatement provision, § 871, make clear that this includes fraudulent conveyances, like that alleged here."[142] But the Restatement section cited refers to this situation: *O*, who owns Blackacre, is induced by fraud to convey title to *D*. *D* conveys to *X* who is not a bona fide purchaser for value. This is an example of constructive trust, not fraudulent transfer. Here, the transferee (*D*) has the bad intent. But in a fraudulent transfer, the *transferor* (O) must have the bad intent.

Be that as it may, Judge Lynch ruled that, in cases where the transferor *D* "actually" intended to hinder creditors, and where *X* has received the transfer, *X* has obtained property through actual fraud. Judge Lynch endorsed the Seventh Circuit's expansion of fraudulent transfer law to require bad intent in *X*'s receiving the fraudulent transfer.

> [T]he debtor-transferee must herself be "guilty of intent to defraud" and not merely be the passive recipient of a fraudulent conveyance. Such intent may be inferred from her acceptance of a transfer that she knew was made for the purpose of hindering the transferor's creditor(s), but it may not be implied as a matter of law.[143]

Thus, nondischargeability required fraudulent receipt by *X* as well as *D*'s intent to hinder *C*. *X*'s intent to defraud was (sensibly) established by *X*'s knowledge of *D*'s intent to defraud.

The fraudulent transfer received by *X* from *D* (via *X Corp.*) amounted to \$100,000. Therefore, \$100,000 is the maximum that *X* owed *C*. But suppose there are 100 *C*s. $C_{2\text{-}100}$ are equally as entitled to bring claims against *X*. Each of them, we shall say, had claims against *D* that exceed \$100,000. Suppose $C_{2\text{-}100}$ each file timely adversary proceedings to exempt their claim from dischargeable. *X* now faces \$10 million in liability for knowingly receiving *D*'s actual fraudulent transfer to *X Corp*. The Uniform Fraudulent Transfer Act, it seems, does not prevent $C_{2\text{-}100}$ from bringing repetitive *in personam* claims against *X*.

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139 *In re* Crivaro, 2017 Bankr. LEXIS 1133, at *9–10.

140 516 U.S. 59, 70 (1995).

141 *Id.* ("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 [Bankruptcy] Act.").

142 *In re* Lawson, 505 B.R. 117, 119 (Bankr. D.R.I. 2014), *vacated*, 791 F. 3d 214, 219 (1st Cir. 2015).

143 *Id.* at 220 (citation omitted).

The matter is different under the UFCA, which does not provide for money judgments at all against *X*. Under the UFCA, the theory against *X* is strictly *in rem*. Under the UFCA, *X* holds fraudulently conveyed funds for the benefit of all the unsecured creditors.[144] If *X* violates trust by converting the funds to her own use, then *X* owes *C* for breach of fiduciary duty.[145]

A unique feature of this theory is that, once *X* pays C_1, *X* has performed the trust, and the trust is over. Later, when C_2 brings an avoidance action against *X*, *X* can then claim the trust no longer exists for C_2. Therefore, *X* does not face multiple liabilities for the same fraudulent conveyance.

By not addressing *in personam* liabilities, the UFCA permits the above solution to multiple liabilities. The UFTA, however, has no express limitation on C_2's *in personam* right against *X*. But, perhaps courts will discover that the UFTA really did intend to describe fiduciary liability and that, once C_1 has exhausted the $100,000 cause of action, C_2 has no *in personam* theory against *X*.

To summarize, *Lawson* involved a genuine fraudulent transfer, unlike *McClellan*, but *C* did not own the fraudulent transfer cause of action against *X*. Rather, *D*'s bankruptcy trustee owned this theory. *C* was therefore in violation of the automatic stay arising from *D*'s bankruptcy when *C* made a claim in *X*'s bankruptcy. Thus, *Lawson* suffered from analytical problems at least as severe as those of *McClellan*. These two rotten apples would set up a circuit split with the Fifth Circuit, which had before it yet another rotten apple.

V. HUSKY

We have seen that, in *McClellan*, the Seventh Circuit had before it a conversion case, yet it made a rule about receipt of fraudulent transfers. In *Lawson*, the First Circuit had before it a creditor that properly had no fraudulent transfer theory; *D*'s bankruptcy divested *C* of that theory and bestowed it on *D*'s bankruptcy trustee. *C* never should have been accorded standing to proceed against *X*. Its actions in the case offended the automatic stay arising from *D*'s bankruptcy.[146] Nevertheless, the First Circuit reiterated the Seventh Circuit's fraudulent transfer dictum and declared that *C* could assert a fraudulent transfer claim against *X* that *C* did not own.

The Fifth Circuit Court of Appeals in *Husky International Electronics, Inc. v. Ritz*,[147] created the circuit court split that would eventually propel the case into the dizzy stratosphere of the Supreme Court docket.[148] Properly, *Husky* was no fraudulent transfer case. Rather, it was an embezzlement case.[149] Nevertheless, it spawned a

[144] *See* Lamb v. Cramer, 285 U.S. 217 (1932).

[145] *See* Post v. Stiger, 29 N.J. Eq. 554, 558 (N.J. Ch. 1878) (*X* "held the property as trustee of [*D's*] creditors, and dealt with it at her peril").

[146] *See* 11 U.S.C. § 362(a)(3) (2018) (prohibiting all action against property of the bankruptcy estate).

[147] 787 F.3d 312 (5th Cir. 2015), *rev'd*, 136 S. Ct. 1581 (2016).

[148] *Id.*

[149] *See generally id.* Embezzlement is "the fraudulent conversion of the property of another by one who is already in lawful possession of it." Sherman v. Potapov (*In re* Sherman), 603 F.3d 11, 13 (1st Cir. 1992).

ruling as to fraudulent transfers, though it is a challenge to ascertain precisely what that rule is.

In *Husky*, *D Corp*. bought inventory on unsecured credit from *C*. *D Corp*. began to fail. Wishing to loot the company, *X*, an officer and shareholder of *D Corp.*, caused *D Corp*. to write checks to various affiliated companies, whom I shall jointly call *X Corp*.[150] *X* was a shareholder (but not the only shareholder) of *X Corp. D Corp*. filed for bankruptcy and, soon thereafter, so did *X*.

In *X*'s bankruptcy, *C* sought to hold *X* liable for *D Corp*.'s cause of action. *C* started an adversary proceeding by filing a complaint against *X* to bar discharge of *C*'s breach of contract claim.

A. How the Case Should Have Unfolded

Let us apply state law to these facts, assuming for the moment that no one is yet bankrupt. A fraudulent transfer is a conveyance of title by *D Corp*. Being a corporation, its affairs are conducted by agents. To be a valid act of the corporation, the agent must be within the scope of his authority. Transfers for no reasonably equivalent value to third parties are not within the scope of *X*'s authority. Such an act can only be authorized by the corporation's board of directors.[151] Therefore, the act of *X* is not the act of *D Corp*. and no fraudulent transfer has occurred. Rather, *X* has *embezzled D Corp*.'s funds and has sent those funds to *X Corp*. *X Corp*., however, has no title to the funds. The funds still belong to *D Corp*.

Suppose now *C* sues *D Corp*. for breach of contract and obtains a money judgment. *C* may, via a writ of garnishment, obtain *D Corp*.'s funds now controlled by *X Corp*.[152] There is no transfer of title that *C* needs to avoid. Fraudulent transfer theory is superfluous. Under a fraudulent transfer theory, *C* is invited to obtain a judicial lien on property to which *X Corp*. has title. But *X Corp*. has no title to the funds in question. *D Corp*. has title, and *C* has full access to these funds via garnishment.

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[150] There were 176 transfers by *D Corp*. to the various *X Corp*. entities. *In re* Ritz, 567 B.R. 715, 727 (Bankr. S.D. Tex. 2017).

[151] *See* DEL. CODE ANN. tit. 8 § 141(a) (2007); Model Bus. Corp. Act § 801(b) (2002); *In re* Newpower, 229 B.R. 691, 699–700 (W.D. Mich. 1999), *aff'd in part*, *rev'd in part*, 233 F.3d 922 (6th Cir. 2000) (implying a vote of the board of directors is needed to remove the taint of theft); Am. Bank & Tr. Co. v. Freeman, 560 S.W.2d 444, 446 (Tex. App. 1977) ("In absence of specific authority from the board of directors, the president of a corporation has no authority to contract for the corporation.").

[152] *See* Harper v. Spencer & Assocs., 446 S.W.3d 53, 56 (Tex. App. 2014) ("Garnishment is one means of collecting on a judgment.").

Meanwhile, *X* stole funds and sent them to *X Corp*. *X* (who no longer has the funds) is guilty of the tort of conversion.[153] This cause of action belongs to *D Corp*.[154] *X* is therefore an "account debtor" of *D Corp*., to use the Article 9 term.[155] Given *C*'s (hypothetical) judgment against *D Corp*. for breach of contract, *C* is in a position to have the Texas sheriff garnish *X*'s obligation to *D Corp*. If so, *X* is required to pay the conversion cause of action to the sheriff on behalf of *C*. *C* does not need a fraudulent transfer theory to make *X* pay.

Similar analysis applies to *X Corp*. If *X Corp*. dissipates the funds *X* stole, *X Corp*. has committed the tort of conversion.[156] *C* does not need an avoidance theory to reach *X Corp*.'s obligation to pay *D Corp*. *C* can garnish *X Corp*. directly, because *X Corp*. owes the conversion debt to *D Corp*.

As we shall see, piercing the corporate veil of either *D Corp*. or *X Corp*. will loom large in *Husky*. But according to the above analysis, *C*, wishing to collect its money judgment, does not need to pierce any corporate veils. *C* has a breach of contract money judgment (we are pretending) against *D Corp*. *X* owes *D Corp*. for the tort of conversion. *C* may garnish this obligation. *X* pays *C* (via the sheriff) without any need to pierce a corporate veil. In short, both fraudulent transfer law and veil piercing are irrelevant to the analysis and should never have been mentioned.

To the mix, we now add in the sequential bankruptcy proceedings of *D Corp*. and *X*. We abandon the pretense that *C* has a money judgment against *D Corp*. for breach of contract.

Prior to *D Corp*.'s bankruptcy petition, *D Corp*. owned choses in action against *X* and *X Corp*. By virtue of the bankruptcy petition, these choses became property of the estate.[157] *C* is required by the automatic stay in *D Corp*.'s bankruptcy to keep its hands off property of the bankruptcy estate.[158] Under the protection of the automatic stay, *D Corp*.'s bankruptcy trustee may pursue these causes of action and *C* may not interfere. In *X*'s bankruptcy, *D Corp*.'s trustee may file a proof of claim for conversion. *D Corp*.'s bankruptcy trustee may seek to bar *X*'s discharge pursuant to

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153 *See* Rogers v. Ricane Enters., Inc., 930 S.W.2d 157, 165 (Tex. App. 1996) ("Conversion is classically defined as the unauthorized and wrongful assumption and exercise of dominion and control over the property of another, to the exclusion of or inconsistent with the owner's rights."); *see In re* Ritz, 567 B.R. 715, 727 (Bankr. S.D. Tex. 2017) ("[*X*], in his capacity as the director of [*D Corp*.], represented that [*D Corp*.] had no claims of any kind when, in fact, [*D Corp*.] has a claim against [*X*] for the $1,161,279.90 of funds that [*X*] transferred out of [*X*'s] account into the accounts of entities which [*X*] controlled.").

154 *See* Great W. Drilling, Ltd. v. Alexander, 305 S.W.3d 688, 695 (Tex. App. 2009) ("To bring a conversion claim, an aggrieved party must have either ownership, possession or the right of immediate possession in the property.").

155 U.C.C. § 9-102(a)(61) (2017) ("'Account debtor' means a person obligated on [a] general intangible.").

156 *See* Houston Nat'l Bank v. Biber, 613 S.W.2d 771, 774 (Tex. App. 1981) ("An action will lie for conversion of money when its identification is possible and there is an obligation to deliver the specific money in question or otherwise particularly treat specific money.").

157 *See In re* Talla, Inc., 34 B.R. 927, 930 (Bankr. E.D. Mich. 1983).

158 11 U.S.C. § 362(a)(3) (2018).

Bankruptcy Code section 523(a)(4) and (a)(6),[159] the provisions appropriate to embezzlement and conversion. *C* has no standing to do any of these things.[160]

At this point, piercing the veil of *D Corp*. (or seeking substantive consolidation of the *D Corp*. and *X* bankruptcies) gives *C* a direct action against *X*. But *C*'s theory against *X* is *C*'s theory against *D Corp*.—breach of contract. No part of section 523(a) exempts breach of contract suits from discharge, where no misrepresentations of fact were made by *X* to *C*. In short, *C*'s legal theory against *X* (given veil piercing) is logically unrelated to *X*'s embezzlement of *D Corp*.'s funds. To be sure, *X*'s obligation to pay a conversion debt is nondischargeable,[161] but this obligation is owed to *D Corp*.'s bankruptcy trustee, not to *C*.[162]

In short, piercing the corporate veil achieves nothing. If *D Corp*. is bankrupt, the conversion cause of action belongs to *D Corp*.'s bankruptcy trustee. *C* violates the automatic stay by pursuing a claim that properly belongs to the *D Corp*. trustee. *C* is left with a breach of contract claim, which is dischargeable. The *D Corp*. bankruptcy trustee can prevent *X*'s discharge for conversion under section 523(a)(6). *C* cannot.

B. How the Case Actually Unfolded

1. The First Bankruptcy Court Opinion

Husky began when *C* filed a complaint to bar discharge of *C*'s breach of contract claim in the *X* bankruptcy.[163] *C* alleged that *X* was liable for *C*'s breach of contract action against *D Corp*. under Texas Business Organizations Code ("TBOC") section 21.223(b). Subsection (a)(2) of this act states that:

> (a) A holder of shares . . . may not be held liable to the corporation or its obligees with respect to:
>
> . . . .

[159] *Id.* § 523(a)(4) ("A discharge . . . does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."); *id.* § 523(a)(6) ("A discharge . . . does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity.").

[160] *In re* Melo, 558 B.R. 521, 551–52 (Bankr. D. Mass. 2016) (demonstrating a situation where an embezzler owed conversion debt to the victim, not to a shareholder of the victim, and creditor had no standing to object to embezzler's discharge).

[161] 11 U.S.C. § 523(a)(4).

[162] A remark about the "trust fund doctrine" is warranted. Corporate officers in Texas are said to owe a fiduciary duty directly to the creditors of the corporation. But, as the bankruptcy court in *Husky* would find, "to pursue a successful trust fund claim, [*C*] must prove that a corporation is a) insolvent and b) ceased to do business at the time of the challenged transaction." *In re* Ritz, 459 B.R. 623, 634 (Bankr. S.D. Tex. 2011), *aff'd*, 787 F.3d 312 (5th Cir. 2015), *rev'd and remanded sub nom*. Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581 (2016) (citing Asanase v. Fatio, 130 F.3d 657, 671 (5th Cir. 1997)). Since *D Corp*. was still doing business at the time of the embezzlements, *C* had no direct claim against *X* under the trust fund doctrine.

[163] *In re* Ritz, 459 B.R. at 627. The district court, however, assumes at one point that *X*'s bankruptcy trustee was pursuing the nondischargeability proceeding. *In re* Ritz, 513 B.R. 510, 538 (S.D. Tex. 2014) ("Judge Bohm found the trustee had proven four badges of fraud by [*X*] and therefore met the requirements for fraudulent transfer under [Texas UFTA] § 24.005.").

> (2) any contractual obligation of the corporation . . . on the basis that the holder . . . is or was the alter ego of the corporation or on the basis of actual of constructive fraud, a sham to perpetrate a fraud, or other similar theory[.][164]

Subsection (b) then sets forth an exception:

> (b) Subsection (a)(2) does not prevent or limit the liability of a holder . . . if the obligee demonstrates that the holder . . . caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder . . . .[165]

The bankruptcy court, however, interpreted Texas law to define fraud as "the misrepresentation of a material fact with intention to induce action or inaction, reliance on the misrepresentation by a person who, as a result of such reliance, suffers injury."[166] Since *X* had made no misrepresentation to *C*, the *D Corp.* veil could not be pierced. *X* was therefore held not liable to *C* for *D Corp.*'s breach of contract.

In one sentence, the bankruptcy court also noted that "the tests for fraud under section 22.223 of TBOC and the requirements of section 523(a)(2)(A) of the Bankruptcy Code are virtually the same."[167] This short half-remark disagrees with the rules set forth in *McClellan* and *Lawson*.

Appropriately, the bankruptcy court did not make a single reference to fraudulent transfer doctrine. Indeed, the district court in the appeal framed the issue: "Did the bankruptcy court err when it ignored that fraudulent transfers . . . are actual fraud within the meaning of Tex. Bus. Org. Code § 21.223(b)?"[168] Properly, the bankruptcy court did *not* err.

2. The Appeal to the District Court

The district court, on appeal, affirmed, but only after throwing a monkey wrench into the gears and flywheels of legal reason.

Although the case was one involving conversion of *D Corp.*'s property by *X*, the district court treated the case as involving *D Corp.*'s fraudulent transfer. Thus, the

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[164] TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2) (Vernon's 2007).

[165] *Id.* § 21.223(b). The bankruptcy court erroneously supposed this statute "allows a creditor of a corporation to pierce the corporate veil and impose liability on an officer, director, or shareholder of the company . . . ." *In re* Ritz, 567 B.R. 715, 721 (Bankr. S.D. Tex. 2017); *see also In re* Ritz, 459 B.R. at 632; *In re* Ritz, 513 B.R. at 525. In fact, the TBOC authorizes liability of "a holder, beneficial owner, subscriber, or affiliate . . . ." TEX. BUS. ORGS. CODE ANN. § 21.223(b). "Holder" means a "holder of shares" per section 21.223(a). Officer liability and piercing the corporate veil do not mix.

[166] *In re* Ritz, 459 B.R. at 633 (citing Trs. of the N.W. Laundry & Dry Cleaners Health & Welfare Tr. Fund v. Burzynski, 27 F.3d 153, 157 (5th Cir. 1994)).

[167] *Id.* at 623.

[168] *In re* Ritz, 513 B.R. at 514.

district court assumed that the victim (*D Corp*.) of an embezzlement had voluntarily transferred title to stolen funds to the transferee (*X Corp*.).

This constitutes a serious analytical error. *Husky* was simply not a fraudulent transfer case. Though analytically erroneous, the assumption is not outcome-determinative as to the veil-piercing aspect of the case. Focusing on TBOC section 21.223(b), which uses the words "actual fraud on the obligee," the district court could have justified piercing the corporate veil as *X* abused *D Corp*.'s corporate form by embezzling.[169] But, such a result can be reduced *ad absurdum*. *D Corp*. owed its creditors millions of dollars,[170] including a debt owed to *C* for $163,999. Suppose *X* embezzled a single dollar. The theft of this pocket change results in imposing upon *X* millions of dollars of liability—not just to *C* but to any other creditor of *D Corp*. The punishment does not fit the crime.

In fact, *C* does not need veil piercing to pursue *X*. *X* has embezzled a hypothetical dollar from *D Corp*. and thus, *X* has committed the tort of conversion against *D Corp*. *X* is an account debtor of *D Corp*. If, in the absence of *D Corp*.'s bankruptcy, *C* had obtained a money judgment against *D Corp*. for *D Corp*.'s breach of contract, *C* could have garnished *X*—for one dollar. Now the punishment fits the crime, once veil piercing is taken off the table.

Let us, as is our custom, waive these points and assume that *X*'s embezzlement is *D Corp*.'s fraudulent transfer to *X Corp*. Properly, *X* falls out of the equation. If *D Corp*. voluntarily conveyed funds to *X Corp*., *X* was acting within the scope of his authority and, indeed, was no embezzler.[171] The district court's holding is in contradiction: *D Corp*.'s veil is pierced because *X* (agent of *D Corp*.) faithfully followed *D Corp*.'s instructions.

So far, it seems as if piercing the *D Corp*. veil makes no sense. But there is another possibility. *D Corp*.'s actual fraudulent transfer justifies piercing *X Corp*.'s veil, where *X* is the shareholder of *X Corp*.[172]

Piercing the *X Corp*. veil may be what the district court in *Husky* meant. In support of this view is the district court's reliance[173] on *Spring Street Partners-IV, L.P. v. Lam*.[174] *Lam* entailed a genuine fraudulent transfer—involving *D*'s voluntary conveyances to *X Corp*. *Husky*, in contrast, involved embezzlement by *X*. *Lam* was

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[169] For such a holding on analogous facts, see *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex. App. 2007).

[170] The bankruptcy court refers to *D Corp*. liabilities of $7.68 million. *In re* Ritz, 567 B.R. 715, 726 (Bankr. S.D. Tex. 2017).

[171] Hagan v. Baird (*In re* B&P Baird Holdings, Inc.), 759 F. App'x 468, 476 (6th Cir. 2019) (holding fraudulent transfer theory against *X* precludes embezzlement theory).

[172] *See* DFS Secured Healthcare Receivables Tr. v. Caregivers Great Lakes, Inc., 385 F.3d 338, 355 (7th Cir. 2004) (certifying to the Indiana Supreme Court as to whether *X Corp*. veil could be pierced because the shareholder aided in receipt of the transfer).

[173] *See In re* Ritz, 513 B.R. at 537 ("This court has found cases that do not require a misrepresentation to pierce the corporate veil to satisfy 'actual fraud' under § 21.223(b) and the standard of 'dishonesty or purpose and intent to deceive for actual fraud . . . ."). The only case cited, however, is *Spring St. Partners-IV, L.P. v. Lam*, 730 F.3d 427 (5th Cir. 2013).

[174] 730 F.3d 427 (5th Cir. 2013).

issued on September 13, 2013, and thus was not available to the bankruptcy court, whose opinion dated from August 4, 2011.[175]

In *Lam*, *C* was a creditor of insolvent *D*. *D* owned valuable shares in a company. *D* conveyed the shares to *X Corp*., an entity established by *X* to receive this fraudulent transfer. *C* therefore had a fraudulent transfer claim against *X Corp*. *C* sought a money judgment against *X* (not against *X Corp*.). Thanks to TBOC section 21.223(b), *X* was made liable because *X Corp*. had received *D*'s fraudulent transfer. Receipt of the fraudulent transfer was held to be an actual fraud involving the use of *X Corp*.'s corporate form. *X* was therefore liable because *X Corp*. received a fraudulent transfer.

The district court wrongly applied *Lam* to the facts of *Husky*. In *Lam*, *C* was able to capture *D*'s fraudulent transfer to *X Corp*. Piercing the *X Corp*. veil, the *Lam* court held *X* liable for what *X Corp*. received. Thus, if *D* had conveyed one dollar to *X Corp*., *C* could have a money judgment against *X* for one dollar. But the district court did not use *Lam* to pierce the *X Corp*. veil. It used *Lam* to pierce the *D Corp*. veil, resulting in *X*'s liability to *C*'s entire breach of contract action. This implies *X*'s unlimited liability for all of *D Corp*.'s debts. The district court, evidently, was confused as to which corporate veil was being pierced.

The district court nevertheless confirmed the bankruptcy court's decision.[176] *C*'s complaint for an exemption from discharge was deemed properly dismissed. Neither the bankruptcy court nor the district court had actually ruled that *X* was liable for *D Corp*.'s breach of its contract with *C*. Both courts took the position that, even if this liability of *X* existed, it would be dischargeable: *X* had never obtained property by misrepresenting facts to *C* at the inception of the debtor-creditor relation between *C* and *D Corp*. Neither court actually got around to piercing the *D Corp*. veil in order to hold *X* liable for breach of contract.

3. The Court of Appeals Creates a Circuit Split

The court of appeals affirmed the lower court's opinion.[177] That is, it affirmed dismissal of *C*'s adversary proceeding to deny *X* a discharge. The court of appeals read Bankruptcy Code section 523(a)(2) as requiring a misrepresentation of fact at the inception of the debtor-creditor relation between *C* and *D Corp*. Thus, it disagreed with the Seventh Circuit's decision in *McClellan v. Cantrell*.[178] The Fifth Circuit found *McClellan* to be "in tension"[179] with the Supreme Court's opinion in *Field v. Mans*,[180] which indeed can be read as locating justifiable reliance at the heart of actual fraud. The court also emphasized the good point that, to the extent *X* is deemed to be the transferor of a fraudulent transfer (not the transferee), the *McClellan*

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[175] *Id.* at 427.
[176] *In re* Ritz, 513 B.R. at 517.
[177] Husky Int'l Elecs., Inc. v. Ritz (*In re* Ritz), 787 F.3d 312, 314 (5th Cir. 2015), *rev'd*, 136 S. Ct. 1581 (2016).
[178] *Id.* at 319–20; *see* McClellan v. Cantrell, 217 F.3d 890, 894–95 (7th Cir. 2000).
[179] *In re* Ritz, 787 F.3d at 317.
[180] 516 U.S. 59, 70 (1995).

reading swallows up much of section 727(a)(2).[181] Of course, I remind the reader that there were no fraudulent transfers in either case—only conversions and embezzlements.

4. Excursus on § 523(a)(6)

We have said that *Husky* is not a fraudulent transfer case. It is a case involving *X*'s conversion. *X* had converted *D Corp.*'s property, but this is a claim that belongs to *D Corp*., not to *C*. If *C* had a pre-petition money judgment against *D Corp*., *C* could garnish *X*'s obligation. But once *D Corp*. was bankrupt, *C* 's ability to garnish *X* is automatically stayed. Only *D Corp*.'s bankruptcy trustee can make *X* pay. Furthermore, in *X*'s bankruptcy, *D Corp*.'s bankruptcy trustee can prevent *X*'s discharge pursuant to section 523(a)(6).[182] *C* has no standing to make this claim, since *C* can only claim that *X* is liable for *D Corp*.'s breach of contract with *C*.

The bankruptcy court had rejected *C*'s section 523(a)(6) claim on the ground that *C* had not really developed an argument. "This court has found no case law where an unsecured creditor trade creditor [sic] has obtained a judgment for nondischargeability under § 523(a)(6) where the debtor has simply failed to honor a contractual obligation to pay for the goods or services provided by that creditor."[183]

Actually, that case law exists, but the case in question is poorly reasoned. In *Murray v. Bammer (In re Bammer)*,[184] *D* conveyed a mortgage to *X*. *X* apparently advanced value to *D*, but *D* was found to have the fatal intent to hinder *C*, and *X* was a bad faith purchaser. *D* filed for bankruptcy where presumably the fraudulent transferred mortgage lien was preserved for the benefit of the bankruptcy estate. Soon thereafter, *X* filed for bankruptcy.

C, a creditor of *D*, sought to hold *X* liable for having received a fraudulent transfer. *C* had no right to do this. All fraudulent transfer theories belonged to *D*'s bankruptcy trustee, not to *C*. Nevertheless, *X* was held liable and *C* sought to block *X*'s discharge under Bankruptcy Code section 523(a)(6)—willful and malicious injury to *C*'s property. What was *C*'s property? *C*'s *in personam* claim against *D*. That is, by accepting a fraudulent transfer from *D*, *X* injured *C*'s in personam claim against *D*.

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[181] *In re* Ritz, 787 F.3d at 320–21.

[182] This opportunity may have been lost, however. *X* received a general discharge under section 727(a). *In re* Ritz, 567 B.R. 715, 728 (Bankr. S.D. Tex. 2017). *X* did not schedule the *D Corp*. trustee as a creditor in its schedules. *Id.* at 729. Unscheduled debts are not dischargeable. 11 U.S.C. § 523(a)(3) (2018). A claim for conversion, however, is dischargeable if the *D Corp*. trustee "had notice of actual knowledge of [*X*'s bankruptcy] case in time" to object to *X*'s discharge under section 523(a)(6). One may suspect that the *D Corp*. trustee had early knowledge of *X*'s bankruptcy petition, yet did not object to *X*'s discharge under Bankruptcy Code section 523(a)(4) or (6), as is required by section 523(a)(3)(B). *D Corp*.'s bankruptcy trustee, as a creditor in *X*'s bankruptcy, had sixty days after the first date set for the section 341(a) creditors meeting, to commence his adversary proceeding. FED. R. OF BANKR. P. § 4004(a).

[183] *In re* Ritz, 459 B.R. 623, 635 (Bankr. S.D. Tex. 2011).

[184] 131 F.3d 788, 793 (9th Cir. 1997). For a case reaching the opposite result, see *Quarre v. Saylor*, 108 F.3d 219, 222 (9th Cir. 1997).

The case can be severely criticized for ignoring the fact that *D*'s bankruptcy trustee successfully recovered the fraudulent transfer, so that *C*'s property was not damaged at all. *C* would be paid by *D*'s bankruptcy trustee *as if D* never fraudulently transferred a mortgage to *X*. *C*'s theory was a transparent attempt to sue *X* for receipt of a fraudulent transfer, when the right to recover the fraudulent transfer belonged solely to *D*'s bankruptcy trustee.

In *Husky*, on appeal to the district court, *C* argued that *X*, not *D Corp*., made fraudulent transfers to *X Corp*.[185] *C* urged the position that because *X* fraudulently conveyed *D Corp*. assets, *C*'s cause of action for breach of contract was maliciously damaged within the meaning of section 523(a)(6). Such a view assumes that an unsecured creditor has an interest in a debtor's property before any judicial lien attaches to it. The district court properly rejected this claim.[186]

The court of appeals agreed that *C* had no section 523(a)(6) case: "[T]here appears to be scant evidence in the record indicating either that [*X*] made these transfers [sic] with the intent to harm [*C*], or that harm to [*C*] was substantially certain due to [*X*'s] actions."[187]

Ironically, section 523(a)(6) *was* the proper ground to deny *X* a discharge. But it was *D Corp*.'s property (not *C*'s) that was willfully and maliciously injured. *C* had no standing to assert a conversion claim belonging solely to the *D Corp*. bankruptcy trustee. If *D Corp*.'s bankruptcy trustee had timely filed an adversary proceeding in *X*'s bankruptcy, then indeed *X* should not have been discharged for embezzling *D*'s funds.

There is further irony: since *X* was an embezzler, *C* sought to block discharge of its breach of contract action under section 523(a)(4)—"fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . ."[188] This the bankruptcy court properly dismissed because *X* owed no fiduciary duty to the creditors of *D Corp*. Rather, *X* owed the duty to *D Corp*.[189] Yet this same "standing" principle (correct as it is) equally applies to *C*'s claims under section 523(a)(6) and, for that matter, section 523(a)(2). *C* had absolutely no standing to pursue any of its claims. At all levels the courts in *Husky* missed this point.

5. The Supreme Court Opinion

On further appeal, the Supreme Court accepted without question that the case involved fraudulent transfer rather than embezzlement. Furthermore, Justice

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[185] *In re* Ritz, 513 B.R. 510, 527 (S.D. Tex. 2014).

[186] *Id.* at 540 ("Not only did [*C*] fail to show . . . that [*X*] acted willfully and maliciously, but this Court notes that as an unsecured creditor, [*C*] did not have a clearly valid claim, lien, right, interest or privileges to the monies transferred out of [*D Corp*.] A breach of contract suit that is an unsecured debt is dischargeable in bankruptcy.").

[187] Husky Int'l Elecs., Inc. v. Ritz (*In re* Ritz), 787 F.3d 312, 321–22 (5th Cir. 2015).

[188] 11 U.S.C. § 523(a)(4) (2018).

[189] *See In re* Ritz, 459 B.R. at 633–34.

Sotomayor was under the misimpression that *X* had already been held liable to *C* for *D Corp*.'s breach of its contract with *C*.[190] This was not the case.[191]

Justice Sotomayor's opinion is difficult to read because it is ambiguous as to whether *X* was supposed to be the *transferor*[192] or the *transferee* of a fraudulent transfer. Sometimes Justice Sotomayor refers to *X* as the transferor.[193] If *X* was indeed the transferor, *X* was so by virtue of piercing the *D Corp*. veil. If this particular veil was pierced, *D Corp*.'s property would become *X*'s property. Accordingly, *X* would have been the transferor.

Additional passages from the opinion presuppose that *X* would lose his discharge if *X* was the *transferor*. This presupposition arose when *X*, presuming he was being viewed as the transferor, argued that transferors could only lose a discharge under the terms of section 727(a)(2). Section 523(a)(2) applies only to *transferees*. It does not apply to *transferors*, *X* asserted. Justice Sotomayor responded by asserting that section 727(a)(2)(A) and section 523(a)(2) do indeed overlap—permissibly so. Justice Sotomayor stated, "[section] 727(a)(2)(A) is a blunt remedy for actions that hinder the entire bankruptcy process."[194] But section 523(a)(2)(A) "is a tailored remedy for behavior connected to specific debts."[195] This remark overlooks the fact that *X*'s behavior hindered the entire bankruptcy process and was *not* tailored to *C*'s specific breach of contract claim.

Thus, the Supreme Court could be interpreted as ruling that, if indeed *X* is the transferor, *X* could lose the discharge if *X* incurred a debt to *C* by having made the fraudulent transfer.[196] This contravenes the statute which requires that *X* obtain *property* (not necessarily *C*'s property) by means of actual fraud.

In his dissent, Justice Thomas took the majority to be viewing *X* as the transferor. Because this was so, section 523(a)(2) "does not fit."[197] On this point Justice Thomas is correct—if *X* is viewed as the *transferor*.

At other times, Justice Sotomayor implies that *X* was the *transferee*.[198] This, in turn, depends on piercing the corporate veil of *X Corp*.

X had rightfully pointed out that Bankruptcy Code section 523(a)(2) requires that *X receive* property through fraud. In response, Justice Sotomayor pointed out that, *if*

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[190] *See* Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1585 (2016) ("The District court held that [*X*] was personally liable for the debtor under Texas law.").

[191] As the Fifth Circuit would hold on remand. *See In re* Ritz, 832 F.3d 560, 566–69 (5th Cir. 2016); *see also infra* text accompanying notes 206–07.

[192] For a case interpreting *X* in *Husky* as the transferor, see *In re Lionetti*, Case No. SA CV 17-2255-MWF, 2019 U.S. Dist. LEXIS 11079, at *12 (C.D. Cal. Jan. 23, 2019).

[193] *See Husky Int'l Elecs., Inc.*, 136 S. Ct. at 1585–86 (*X* "drained [*D Corp*.] or assets [*D Corp*.] could have used to pay its debts to creditors like [*C*] by transferring large sums of [*D Corp*.] funds to [*X Corp*.]"); *id.* at 1586 ("In transferring [*D Corp*.'s] assets, [*X*] may have hindered [*C*'s] ability to recover its debt . . . .").

[194] *Id.* at 1589.

[195] *Id.*

[196] *Id.* n.3.

[197] *See id.* at 1590 (Thomas, J., dissenting).

[198] For cases assuming *X* in *Husky* was the recipient of a fraudulent transfer, see *Harbor Bank of Md. v. Anderson (In re Anderson)*, No. 15-18781-WIL, 2018 Bankr. LEXIS 854, at *60 (Bankr. D. Md. Mar. 22, 2018).

a transferee had received a fraudulent transfer with bad intent, and if, by virtue of that receipt, the transferee became a debtor to the first debtor's creditor, the debt arising from receipt of the fraudulent transfer fit the terms of section 523(a)(2). That is, the recipient had received property "obtained by" fraud. In so remarking, Justice Sotomayor implied that *X* could *not* be held under section 523(a)(2) if *X* were the *transferor*. Thus, nondischargeability is visited only on *transferees* of fraudulent transfers.

The passages where Justice Sotomayor does this work is marred by semantical confusion. Justice Sotomayor wrote of obtaining *debts*, which is confusing.[199] What a transferee must obtain is *property* for which acquisition a debt is owed.[200] Justice Sotomayor's remarks are coherent only if one substitutes "property" for "debts." With this substitution, Justice Sotomayor wrote:

> [*X*'s] next point of resistance rests on § 523(a)(2)(A)'s requirement that the relevant debt be "for money, property, services, or . . . credit . . . *obtained by* actual fraud." (Emphasis added.) The argument . . . posits that fraudulent conveyances (unlike other forms of actual fraud) cannot be used to "obtai[n]" [property] because they function instead to hide valuables that a debtor already possesses.[201]

In this passage, Justice Sotomayor confuses hiding assets with conveying them away.[202] Fraudulent transfer law does not have the power to show where in the backyard *D* buried her gold bullion. Fraudulent transfer law invites attachment of judicial liens on third party property in which the transferor surrenders title. Be that as it may, I take *X* as having argued that he was a *transferor*. As such he didn't obtain property but rather gave it away. Justice Sotomayor's response was that *if X* was a transferee, then *X* obtained property by actual fraud:

> It is of course true that a transferor does not "obtai[n]" [property] in a fraudulent conveyance. But the recipient of the transfer--who, with the requisite intent, also commits fraud--can "obtai[n]" assets "by" his or her participation in the fraud. If that recipient later files for bankruptcy, any debts "traceable" to the fraudulent conveyance will be nondischargeable under § 523(a)(2)(A). Thus, at least

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[199] Judge Posner had warned against this confusion. "The words 'obtained by' go with 'money, property, [or] services,' not with 'debt' . . . . A debt is not something you obtain; it is something you incur as a consequence of having obtained money or something else of value from another person (the creditor)." McClellan v. Cantrell, 217 F.3d 890, 895 (7th Cir. 2000) (citations omitted).

[200] *See* Cohen v. De La Cruz, 523 U.S. 213, 218 (1998) ("'To the extent obtained by' modifies 'money, proper, services, or . . . credit'—not 'any debt' . . . .").

[201] *Husky Int'l Elecs., Inc.*, 136 S. Ct. at 1589.

[202] On this distinction, see GLENN, *supra* note 12, at 75–76.

> sometimes a debt "obtained by" a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A).[203]

This passage seems to say that *X* could be liable as a *transferee*. It also concedes that *X* could *not* be liable if *X* was a *transferor*. If *X* was a transferor, then *X* has not *obtained* property by actual fraud within the meaning of section 523(a)(2). To cap off the confusion, Justice Sotomayor considers whether *X* is *both* transferor *and* transferee:

> [*X*'s] situation may be unusual in this regard because [*C*] contends that [*X*] was both the transferor and the transferee in his fraudulent conveyance scheme, having transferred [*D Corp.*] assets to other companies he controlled. We take no position on that contention here and leave it to the Fifth Circuit to decide on remand whether the debt [sic] to [*C*] was "obtained by" [*X*'s] asset-transfer scheme.[204]

This passage does indeed "take a position." It requires *obtainment* of property. Thus, on remand, Justice Sotomayor expected the lower courts to determine whether *X* was a *transferee* of property that belonged to *C*. Whether *X* was the *transferor* would be irrelevant.

Thus, "obtainment" is viewed as key. But whose property did Justice Sotomayor suppose *X* was fraudulently obtaining? There is a hint that Justice Sotomayor viewed *C* as owning *D Corp*. property even before *D Corp*. (via the agency of *X*) transferred funds to *X Corp*. Justice Sotomayor had located a legitimate overlap between sections 523(a)(2) and 526(a)(6). Fraudulent transfers, she ruled, *could* injure *C*'s property. "The debtors who commit fraudulent conveyances . . . could likewise also inflict 'willful and malicious injury' under § 523(a)(6). There is, in short, overlap . . . ."[205] Thus, when *D Corp*. conveyed *its* funds to *X Corp*., it conveyed *C*'s funds to *X Corp*. Accordingly, *X* (assuming the piercing of *X Corp*.'s veil) had obtained *C*'s property within the meaning of section 523(a)(2).

There is a further contradiction. The Supreme Court seemed unaware of, or at least did not mention, the fact that *D Corp*. (as well as *X*) had filed for bankruptcy. This fact should have been outcome-determinative. If *X* was liable as the transferee of a fraudulent transfer (assuming the piercing of the *X Corp*. veil), this liability was to the bankruptcy trustee of *D Corp*., not to *C*. *C* was barred from the automatic stay from pursuing its fraudulent transfer claim. This very claim passed to *D Corp*.'s bankruptcy trustee when *D Corp*. filed its bankruptcy petition. Thus, *X*, as the transferee, may have obtained property by actual fraud, but *X* obtained *D Corp*.'s property, not *C*'s property. *X*'s debt to *D Corp*.'s bankruptcy trustee may have been nondischargeable, but this was *D Corp*.'s bankruptcy trustee's claim to make, not *C*'s

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[203] *Husky Int'l Elecs., Inc.*, 136 S. Ct. at 1589.
[204] *Id.* n.3.
[205] *Id.* at 1588.

claim. Ironically, in seeking to deny *X* a discharge, *C* obtained property illicitly from *D Corp*.'s bankruptcy trustee, the very thing *X* was accused of doing.

To summarize, the Supreme Court was unable to decide whether *X* was the transferor or the transferee of a fraudulent transfer—whether the *D Corp*. veil or the *X Corp*. veil had been pierced. Both positions generate contradiction. If *X* was the transferor, then section 523(a)(2) does not apply for the reason dissenting Justice Thomas said: *X* did not *obtain* *C*'s property, if indeed *C* had property in this case at all. If *X* was the transferee, he was a transferee of property under the control of *D Corp*.'s bankruptcy trustee. Whatever property rights *C* had under state fraudulent transfer law passed to *D Corp*.'s bankruptcy trustee when *D Corp*. filed for bankruptcy. Finally, the case was not a fraudulent transfer case in the first place; it was an embezzlement case. The bankruptcy trustee for *D Corp*. had a claim against *X* for conversion, which was nondischargeable under section 523(a)(6). Section 523(a)(2) should not have figured in the case. If *D Corp*. was the victim of a theft, *D Corp*. could not have the requisite bad intent that "actual fraud" in section 523(a)(2) requires.

6. On Remand

On remand, the Fifth Circuit noted that it had never ruled on whether *X* owed *C* a debt under Texas law. The district court had expressed its conditional opinion that a debt existed, but that it did not matter since *C*'s breach of contract claim was dischargeable. The Fifth Circuit on remand vacated the district court's opinion because its interpretation of state law was based on facts never found to exist by the bankruptcy court—that a fraudulent transfer was indeed made.[206] It nevertheless agreed with the district court that "if [*C*] can show that [*X*'s] transfers in this case satisfy the actual fraud prong of TUFTA, then it can also show that [*X*'s] conduct constitutes actual fraud for purposes of veil-piercing."[207]

In this passage, *X* is identified as the transferor. This identification, however, entails a contradiction. The court holds that if *X* is the transferor, the *D Corp*. veil should be pierced. But *X* is the transferor *only if* the *D Corp*. veil is pierced. Until the veil is pierced, *D Corp*. is the transferor and *X Corp*. is the transferee. The court is caught in the chicken-and-egg—"which came first?"—quandary. The Fifth Circuit has pulled itself up by its bootstraps. In any case, the Fifth Circuit issued these instructions to the bankruptcy court:

> If the bankruptcy court concludes on remand that [*X*'s] conduct satisfies the actual fraud prong of TUFTA and that the actual fraud

[206] Husky Int'l Elecs., Inc. v. Ritz (*In re* Ritz), 832 F.3d 560, 569 (5th Cir. 2016) ("Because the bankruptcy court—the fact finder in this case—never drew an inference of actual fraud here, even if its factual findings are consistent with that inference, the district court erred in holding that Ritz was liable to Husky under Texas law.").

[207] *Id.* at 568.

> was for [*X*'s] "direct personal benefit," then [*X*] is liable for [*D Corp*.'s] debt to [*C*] under Texas's veil-piercing statute and the bankruptcy court must then address whether [*X*] should be denied a discharge under 11 U.S.C. § 523(a)(2)(A), consistent with the Supreme Court's opinion in this case. If, however, the bankruptcy court concludes that [*X*'s] conduct does not amount to actual fraud under Texas state law, then there is no debt to discharge, and the question of dischargeability under § 523(a)(2)(A) becomes moot.[208]

Properly, if these instructions were followed, *X* would be entitled to a discharge because there was no fraudulent transfer in the case—only an embezzlement. As to the embezzlement and conversion, *D Corp*.'s bankruptcy trustee has standing to seek denial of discharge under section 523(a)(4) or (6). *C* has no such standing.[209] *X* did not embezzle from *C*. *X* embezzled from *D Corp*.

On further remand, the bankruptcy court found that "actual fraud" justified piercing the *D Corp*. veil. Thus, *X* was liable for *C*'s breach of contract claim against *D Corp*. Furthermore, the same actual fraud that justified piercing the *D Corp*. veil justified *X*'s nondischargeability under section 523(a)(2).

The bankruptcy court changed horses in the middle of the stream as to whether *X* was the transferor or the transferee. Sometimes *D Corp*. was the transferor. Thus, the bankruptcy court refers to *D Corp*., "through X's actions," as the transferor.[210] Sometimes, however, *X* (not *D* Corp.) was the transferor.[211] The bad intent was held to be *X*'s intent. That implies *X* was the transferor.[212]

In the context of locating badges of fraud,[213] the court admitted that it alternated between treating *D Corp*. as the transferor and treating *X* as the transferor. One of the badges is "debtor [i.e., the transferor] retained possession or control of the property transferred."[214] The court refers to *X* as retaining the transfer (because he controlled *X Corp*.). Thus, *X* was thus the transferor.[215]

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[208] *Id.* at 569. The Fifth Circuit relegated the bankruptcy court to investigate the badges of fraud, of which TBOC section 24.005(b) lists eleven. *See supra* note 28 and accompanying text.

[209] In any case, *C*'s section 523(a)(6) claim did not survive appeal. *In re* Ritz, 567 B.R. 715, 721 n.4 (Bankr. S.D. Tex. 2017).

[210] *See id.* at 727, 734–35, 745, 747.

[211] *See id.* at 730, 739–40, 745–46.

[212] *Id.* at 769. Very frequently the court referred to *X* as the person who "orchestrated" the transfers. *Id.* at 720, 730, 732, 735, 739–40, 743–50, 753, 755–56, 758–59, 763 n.27, 764, 771.

[213] The court interpreted Texas law as requiring "several of these 'badges of fraud' must be present." *Id.* at 740 (citing Mladenka v. Mladenka, 130 S.W.2d 397, 405 (Tex. App. 2004)). Consulting a dictionary, the court discovered "several" means three or more. *Id.* at 741. Ultimately, the court found eleven badges to be present. *Id.* at 753–54.

[214] UNIF. FRAUDULENT TRANSFER ACT § 4(b)(2) (1984).

[215] *See In re* Ritz, 567 B.R. at 744.

Another badge of fraud is concealment of the transfers.[216] The court speaks of *X*'s actions to conceal the transfers in *D Corp*.'s bankruptcy filing.[217] Thus, *X* was the transferor.

On other occasions, *X Corp*. was deemed to be the transferee.[218] Actual fraud thus justified piercing the *X Corp*. veil. If the *X Corp*. veil were pierced, *X* could be liable as the transferee. "[*X*] transferred $1,161,279.90 out of [*D Corp*.'s] account into the accounts of [*X Corp*.] Thus, [*X Corp*.] obtained money from [*D Corp*.] Indeed, as discussed in more detail below, [*X*] himself effectively obtained these moneys from [*D Corp*.] . . . ."[219] Thus, *X* was the transferor by piercing the *D Corp*. veil. *X* was transferee by piercing the *X Corp*. veil.

TBOC section 21.223(b) predicates veil piercing on actual fraud. For this purpose, it is immaterial whether *X* is a transferor or transferee of a fraudulent transfer. But application of section 523(a)(2)(A) is more rigorous. It requires that *X*'s debt be for property "obtained by" actual fraud. However, treating *X* as the transferee raises the problem that *C* has no property interest in fraudulent transfer proceeds. Rather, these proceeds belong to *D*'s bankruptcy trustee. Thus, *C*'s claim would be for breach of contract, but the nondischargeable claim arising from obtainment of property belongs to the *D Corp*. trustee.

In order to deny *X* a discharge of *C*'s contract claim, the court, wary of this contradiction, needed a new tack. Basically, *X* was the transferor. The transfer justified piercing the *D Corp*. veil. *X*'s liability for *C*'s breach of contract was "obtained by" the fact that *X* was the transferor. Here is the passage from the bankruptcy court's opinion where this work was done:

> [A] personal debt of [*X*] arose due to [*X Corp*.] obtaining funds from [*X*'s] fraudulent conduct. This is so because of the veil-piercing statute of [TBOC] § 21.223(b). This statute implies personal liability on [*X*] for the $163,999.38 Debt.[220] There is no question that the creation of this personal obligation is directly traceable to—i.e., resulted from—[*X*'s] fraudulent actions in orchestrating the transfers of $1,161,279.90[221] out of [*D Corp*.'s] account and into the accounts of [*X Corp*.][222]

In this passage, the court slides from piercing the *X Corp*. veil to piercing the *D Corp*. veil. *X* as the transferor committed transfer fraud and that led to piercing the *D Corp*. veil. *X*'s breach of contract liability was justified by veil-piercing based on

[216] UNIF. FRAUDULENT TRANSFER ACT § 4(b)(7).
[217] *See In re* Ritz, 567 B.R. at 748–49.
[218] *See id.* at 743.
[219] *Id.* at 762.
[220] This was the breach of contract debt.
[221] This was the debt arising from receipt of fraudulent transfers, a claim belonging to the *D Corp*. bankruptcy trustee.
[222] *In re* Ritz, 567 B.R. at 762.

this fraud. Simultaneously, the contractual obligation arose from the fraudulent *obtainment* of *D Corp*. funds. That is, *X* (as transferee) obtained *D Corp*. funds and, because of this, *C*'s breach of contract claim arose against *X* (because of piercing the *X Corp*. veil). This last move was crucial for avoiding the point that the fraudulent transfer cause of action really belongs to the *D Corp*. trustee.

This was a deft move, and one for which Supreme Court precedent could be cited. In *Cohen v. De La Cruz*,[223] a landlord charged more rent than local price controls permitted. The local rent control administrator ordered a refund. The landlord responded by filing for bankruptcy. The tenants made a claim for treble damages and attorneys' fees and objected to the landlord's discharge.[224] The landlord protested that treble damages are beyond the scope of section 523(a)(2)(A) because they "do not reflect money, property, or services the debtor 'obtained.'"[225] The Supreme Court disagreed:

> [T]he phrase "to the extent obtained by" in § 523(a)(2)(A), as the Court of Appeals recognized, does not impose any limitation on the extent to which "any debt" arising from fraud is excepted from discharge. "[T]o the extent obtained by" modifies "money, property, services, or . . . credit"—not "any debt"—so that the exception encompasses "any debt . . . for money, property, services, or . . . credit, to the extent [that the money, property, services, or credit is] obtained by" fraud. The phrase thereby makes clear that the share of money, property, etc., that is obtained by fraud gives rise to a nondischargeable debt. Once it is established that specific money or property has been obtained by fraud, however, *"any debt" arising therefrom is excepted from discharge*.[226]

Thus, the Supreme Court itself only requires that *some* property be acquired by fraud. In the *Husky* case, *X Corp*. acquired *D Corp*.'s property by actual fraud. Once that predicate is met, any debt whatsoever connected with the fraud is swept into the nondischargeability net.[227]

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[223] 523 U.S. 213, 223 (1998).

[224] *See* N.J. STAT. ANN. § 56.8-2 ("The act . . . by any person of . . . fraud . . . in connection with the sale . . . of real estate . . . is declared to be an unlawful practice . . . ."); *id.* § 56:8-19 ("Any person who suffers any . . . loss . . . as a result of . . . any . . . act . . . declared unlawful . . . may bring an action . . . . In any action under this section the court shall . . . award threefold the damages sustained by any person in interest. In all actions under this section . . . , the court shall also award reasonable attorney's fees, files fees and reasonable costs of suit.").

[225] Cohen v. De La Cruz (*In re* Cohen), 106 F.3d 52, 60 (3d Cir. 1997) (Greenberg, J., dissenting).

[226] *Cohen*, 523 U.S. at 218–19 (emphasis added).

[227] *See In re* Torres-Montoya, 584 B.R. 56, 62 (Bankr. D.N.M. 2018) ("Given *Cohen*'s decoupling of 'debts' from 'money . . . obtained by . . . actual fraud,' there is nothing in the statute requiring that the money obtained by the fraud come from the creditor.").

In essence, *X* defrauded the *D Corp.* bankruptcy trustee. Therefore, the bankruptcy court reasoned, *C* (who lost no "property" due to fraud)[228] deserves a judgment that its breach of contract claim is nondischargeable under section 523(a)(2)(A).

CONCLUSION: WHAT DOES *HUSKY* MEAN?

There is no denying that the opinion in *Husky* verges on incoherence. From the wreckage, can we obtain some meaning? I set forth the following propositions:

1. Section 523(a)(2) denies discharge for any debt for "property . . . to the extent [the property was] obtained by . . . actual fraud . . . ."[229] We may not read this sentence to mean that *C* once had property and that *C* lost that property to *D*. *D* must *obtain* property—from somebody. If *D*'s obtainment of somebody else's property causes *C* to have a claim against *D*, then *C*'s claim becomes nondischargeable. Thus, Judge Posner's "free-form obtainment" reading has been adopted by the Supreme Court in *Husky*.[230]

On the other hand, *C* must show that *C*'s claim arises *because D* obtained property. As a counterexample, suppose *C* has a breach of contract claim against *D* and, by coincidence, *D* defrauds *V* out of property through false pretenses. *C*'s breach of contract claim does not arise from *D*'s obtainment of property. Therefore, *C*'s claim is dischargeable. *C* was not the party defrauded. *V* was.

2. Because free-form obtainment is the rule, receiving a fraudulent transfer can trigger nondischargeability of the transferee. The transferor must have an actual intent to hinder creditors. The transferee must also be guilty of intent to hinder creditors. As suggested in *Sauer Inc. v. Lawson (In re Lawson)*,[231] where *D* fraudulently transfers to *X*, *X* is a party to actual fraud where *X* has knowledge of *D*'s actual intent. Since *D*'s intent is embodied in the badges of fraud, *X*'s knowledge of the badges implies that *X*'s debt for receipt of the fraudulent transfer is nondischargeable.

3. In *Husky*, the Supreme Court assumed (wrongly) that *D Corp.* had made a fraudulent transfer. It implied that *X* had obtained property in a fraudulent transfer (though it sometimes treated *X* as the transferor). *D Corp.* was in bankruptcy. Properly, the automatic stay should have prevented *C* from pursuing *X* for the fraudulent transfer. This right belongs solely to *D Corp.*'s bankruptcy trustee. Yet *C* was permitted to pursue *X* all the same.

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[228] That *C* lost no property presumes that unsecured creditors like *C* have no interest in *D Corp.*'s property. Once *D Corp*. was bankrupt, the fraud was perpetrated on the *D Corp*. bankruptcy trustee.

[229] 11 U.S.C. § 523(a)(2) (2018).

[230] Free-form obtainment is illustrated by *In re Thompson*, 555 B.R. 1 (B.A.P. 10th Cir. 2016). There, *D* (shareholder of *D Corp.*) received property from *D Corp*. *D* did acts that defrauded state regulatory agencies into permitting *D Corp*. to conduct business., *C* had a negligence claim against *D Corp*. State law permitted veil piercing because of *D*'s fraudulent acts. *C*'s negligence claim against *D* was nondischargeable in *D*'s bankruptcy because *D* obtained *D Corp*. property fraudulently. *See* Scott F. Norberg, *Fraudulent Transfers and the Fresh Start in Bankruptcy*, 93 AM. BANKR. L.J. 139, 151 (2019).

[231] 791 F.3d 214 (1st Cir. 2015), *cert. denied*, 136 S. Ct. 2443 (2016).

Does *Husky* contradict cases like *American National Bank v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*?[232] In *MortgageAmerica*, *C* had commenced fraudulent transfer proceedings against *X*. After *D*'s bankruptcy petition, *C* continued the litigation. *D*'s bankruptcy trustee obtained a ruling that, by continuing the litigation, *C* was in violation of the automatic stay.

Husky can perhaps be reconciled with the *MortgageAmerica* result. In *Husky*, *C* was not pursuing a fraudulent transfer theory. Rather, *C* was pursuing a breach of contract theory, which was triggered because *X* obtained *D Corp*. property through actual fraud. If *C* asserted a fraudulent transfer theory, *C* would have been in violation of the automatic stay. Therefore, *MortgageAmerica* is still the law. *Husky* should be limited to its facts, where *D Corp*.'s "fraudulent transfer" triggered piercing the *D Corp*. veil with regard to *C*'s breach of contract claim.

4. Stealing or receiving stolen property can also trigger nondischargeability under section 523(a)(2) because stealing property can be an actual fraud. The *Husky* case on remand stands for that proposition, in that *X*'s embezzlement of funds justified piercing the veil of *D Corp*. to hold *X* liable for *D Corp*.'s debts. "Actual fraud" is what Texas law requires for piercing the corporate veil. Thus, the recipient who steals directly or who knowingly receives property stolen by someone else has obtained property fraudulently within the meaning of section 523(a)(2).[233]

Making an actual fraudulent transfer has always triggered general loss of discharge pursuant to Bankruptcy Code section 727(a)(2). The transfer must have occurred within one year of the transferor's bankruptcy petition.[234] Making an actual fraudulent transfer more than a year before the bankruptcy petition does not trigger loss of discharge under section 523(a)(2) for the reason Justice Thomas articulated in

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[232] 714 F.2d 1266 (5th Cir. 1983).

[233] *See In re* Koukhtiev, 576 B.R. 107, 132–33 (Bankr. S.D. Tex. 2017); *In re* Zak, 573 B.R. 13, 44–45 (Bankr. D. Mass. 2017) (calling the theft from a partnership a fraudulent transfer). The real estate version on this point was present in *Siverio v. Rodriguez (In re Siverio)*, 253 F. Supp. 3d 418, 418–19 (D.P.R. 2017). In this case *O* owned real property. *O* requested a loan from X_1. X_1 agreed to lend if *O* conveyed fee simple absolute to X_1. X_1 promised to reconvey fee simple absolute to *O* if *O* repaid the loan. X_1 thereafter conveyed the property to X_2, a bad faith purchaser. X_2 conveyed title to X_3, a good faith purchaser. X_2 filed for bankruptcy in chapter 7 but converted the case to chapter 13. *O* claimed that X_2's debt for receiving stolen real estate was nondischargeable under section 523(a)(6). *O* did not stop there. Debts nondischargeable under section 523(a)(6) in a chapter 7 case are dischargeable in a chapter 13 case. Debts nondischargeable under section 523(a)(2) are nondischargeable both in chapter 7 and chapter 13 cases. *O* sought a ruling that section 523(a)(2) also applied, and the district court, relying on *Husky*, agreed. X_2 had received stolen real property and so obtained property by actual fraud. The above comments presuppose that the debt held nondischargeable is a claim for conversion of the stolen property itself. Where *C* claims a contract debt against *D Corp*. and *X* (as guarantor of *D Corp*.), and where *X* loots *D Corp*. assets, *C*'s contract debt is unrelated to obtainment of the loot and so *C*'s contract claim cannot be attributed to *X*'s actual fraud without piercing the *D Corp*. veil. *See* Prado v. Erickson (*In re* Erickson), 584 B.R. 816 (Bankr. W.D. Tex. 2017). On the other hand, *D Corp*. has a claim for conversion, and *D Corp*. may assert the nondischargeability of that claim.

[234] In *Husky*, *D Corp*. filed for bankruptcy on June 12, 2008. *In re* Ritz, 567 B.R. 715, 727 (Bankr. D. Mass. 2017). The last fraudulent transfer from *D Corp*. to *X Corp*. relevant for 727(a)(2) was in May 2007. *Id.* at 729.

his dissent: section 523(a)(2) requires obtainment of property by the bankrupt debtor.[235] Transferring property does not suffice.[236]

This leads to the following anomaly. Suppose, thirteen months before bankruptcy, *D*, with intent to hinder *C*, transfers a gold brick to *X*. *X* has the requisite bad *scienter*. That is, *X* has knowledge of the badges of fraud. *D* is off the hook and enjoys a cheerful fresh start. *X*, however, is not entitled to a discharge thanks to section 523(a)(2). *D* had the bad intent and is scot free. *X*, with mere knowledge, is liable for life.

Judge Posner in *McClellan*, worried about this anomaly.[237] His solution was to suggest that a contractual claim against *D* becomes nondischargeable when *D* makes a fraudulent transfer. But this solution must be rejected because *D*, as transferor to *X*, does not "obtain" property by fraud, as section 523(a)(2) requires. Therefore, we must conclude that the result in *Husky* (and *McClellan*) creates the anomaly Judge Posner feared.

5. In spite of proposition 4 above, if *C* has a claim against *D* because *D* transferred property (but not *C*'s property) to *X*, then *C*'s claim is not dischargeable in *D*'s bankruptcy under section 523(a)(2)(A).[238] This occurred in *Husky* where the theft justified piercing the veil between *D Corp*. and *X*, making *X* the transferor. The fact that *X* was also the transferee is irrelevant to this proposition. Thanks to veil piercing, *X* can be both transferor *and* transferee.[239]

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[235] Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1591 (2016) (Thomas, J., dissenting) ("The upshot of the phrase 'obtained by' is that § 523(a)(2) covers only those debts that result from fraud at the inception of a credit transaction. Such a debt caused by fraud necessarily '*follows* a transfer of value or extension of credit induced by falsity or fraud.'") (citation omitted).

[236] *See In re* Vanwinkle, 562 B.R. 671 (Bankr. E.D. Ky. 2016); *In re* Barry, 559 B.R. 654, 662–63 (Bankr. M.D. Pa. 2016) (ruling *C*'s section 523(a)(2) claim insufficient because "[*C* did] not allege that the transfer . . . constituted actual fraud. Instead, [*C*] allege[d] that false statements made by [*D*] in pledging [the property] as collateral constituted actual fraud"). *But see In re* Cottrell, Case No. 17-55057 (JAM), 2019 Bankr. LEXIS 421, at *10 (Bankr. D. Conn. Feb. 12, 2019) (holding the claim against transferor as nondischargeable under section 523(a)(2)).

[237] *See* McClellan v. Cantrell, 217 F.3d 890, 895 (7th Cir. 2000).

[238] If *C* has a claim against *D* because *D* transferred *C*'s property to *X*, then *C*'s claim is not dischargeable in *D*'s bankruptcy under section 523(a)(6), provided *D*'s act was willful and malicious.

[239] Nevertheless, veil-piercing should be openly sought and argued for, not assumed *sub silentio*, as happened in *DZ Bank Deutsche Zentral-Genossenschafts Bank v. Meyer*, 869 F.3d 839 (9th Cir. 2017). In *Meyer*, *SP* had a $1.7 million secured claim against *D Corp*. *X* guaranteed this loan. *X* was the sole shareholder of *D Corp*., and also of X_1 *Corp*. X_2 *Corp*. was owned by *X Trust*, of which *X* was beneficiary. *D Corp*. and *X* were insolvent. *X* caused *D Corp*. to convey $123,200 to X_1 *Corp*. As to this $123,200, *SP* had a security interest in them. But assuming *D Corp*. transferred the $123,200 from a deposit account, X_1 *Corp*. took free of *SP*'s security interest under U.C.C. § 9-320(b)—unless X_1 *Corp*. was in collusion with *D Corp*. Collusion is a reasonable assumption. Indulging therein, X_1 *Corp*. received $123,000 encumbered by *SP*'s security interest. X_1 *Corp*. then conveyed the $123,200 to X_2 *Corp*, plus $261,800 of its other assets. As to the $123,200, we continue to assume that collusion was in the air. So U.C.C. § 9-332(b) continued not to apply. As to the $261,800, this was a pure gift by X_1 *Corp*. to X_2 *Corp*. Thus, X_1 *Corp*. transferred a total of $385,000 to X_2 *Corp*. As a result, *X*'s shares in X_1 *Corp*., previously worth $261,800, were now worthless. But the shares of X_2 *Corp*. (in which *X* had an equitable interest) increased by $261,800. Newly enriched, X_2 *Corp*. promised to pay $385,000 to *X* over time. We are not told whether this promise was ever fulfilled. It does appear the promise was a gratuitous one, in that the bankruptcy court rejected *X*'s testimony that *X* had by coincidence lent X_2 *Corp*. exactly $385,000. Therefore, presumably, X_2 *Corp*. still retained the $385,000. *X* then filed for

These five propositions are plausible interpretations of the baffling *Husky* opinion, surely one of the most obtuse Supreme Court opinions since Justice Oliver Wendell Holmes wrote *Moore v. Bay*[240]—yet another fraudulent transfer catastrophe. But that is another, much older story.[241]

bankruptcy. *SP* brought an action against *X* in *X*'s bankruptcy seeking to render $385,000 of *SP*'s $1.7 million claim nondischargeable under Bankruptcy Code section 362(a)(2)(A). The bankruptcy court agreed in part. It rendered *SP*'s claim nondischargeable for $123,200. This makes no sense. The $123,200 could be located with X_2 *Corp*. *X* never received this fund. Section 523(a)(2)(A) requires *receipt* of property through fraud. Here there was neither receipt nor fraud. The Ninth Circuit reversed. It thought *D* should not receive discharge for $385,000 (not just $123,200). Again, *X* never received this sum. And since it was still with X_2 *Corp*., and since *X* had an equitable interest in this $385,000, there was no fraud. What about the fact that *X* was neither the transferor nor the transferee? No matter. The court read the UFTA as not requiring this. *Id.* at 845 ("The Eleventh Circuit rejected that argument, explaining that FUFTA did not require the debtors, themselves, to have legal title to the assets transferred.") (citing Wiand v. Lee, 753 F.3d 1194, 1203 (11th Cir. 2014)). *Wiand* is itself a case where the court found itself confused over whether a transferor was a debtor or a creditor. But this is a story I have considered elsewhere. *See* Carlson, *Constructive Trusts and Fraudulent Transfers*, *supra* note 56, at 437–38.

240 284 U.S. 4 (1931).

241 *See* Carlson, *Logical Structure*, *supra* note 19, at 195–97.