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***HUSKY INTERNATIONAL ELECTRONICS, INC. V. RITZ:
RETHINKING ACTUAL FRAUD, BADGES OF FRAUD, AND
PLEADING STANDARDS IN FEDERAL BANKRUPTCY
LITIGATION***

MEAGAN GEORGE*

Bankruptcy law seeks to achieve a balance between two undesirable outcomes: debtors so encumbered by debt that they can never again become productive, solvent members of society and rightful creditors being unable to collect on the loan that they extended with the expectation of being repaid.¹ In 1978, Congress passed the Bankruptcy Reform Act to amend the existing Federal Bankruptcy Code.² One of the amendments Congress made was in Section 523(a)(2)(A), where it added “actual fraud” to a list of actions excepting a debtor from discharge of their debt.³ The updated Section 523(a)(2)(A) now states: “A discharge” of a debt under the Bankruptcy Code “does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud”⁴

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1. *Understanding Bankruptcy*, BANKR. C.D. CAL., <http://www.cacb.uscourts.gov/understanding-bankruptcy> (last visited May 17, 2017) (“The primary purposes of the law of bankruptcy are: to give an honest debtor a ‘fresh start’ in life by relieving the debtor of most debts, and to repay creditors in an orderly manner to the extent that the debtor has property available for payment.”).

2. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. Notably, the Bankruptcy Reform Act of 1978 created the federal bankruptcy courts and “revised and codified Title 11 of the U.S. Code which contained the substantive and procedural laws of bankruptcy.” *Landmark Judicial Legislation: The Establishment of Bankruptcy Courts: “An Act to Establish an Uniform Law on the Subject of Bankruptcies”*, FED. JUDICIAL CTR., http://www.fjc.gov/history/home.nsf/page/landmark_20.html (last visited May 17, 2017).

3. S. REP. NO. 95-989, at 78 (1978) (“[A]ctual fraud’ is added as a ground for exception from discharge.”).

4. 11 U.S.C. § 523(a)(2)(A) (2012).

The meaning of “actual fraud” in this context has been an area of contention since the term’s addition in 1978.⁵ Federal courts of appeal have disagreed over whether actual fraud requires the debtor to make a misrepresentation to her creditor.⁶ In *Husky International Electronics, Inc. v. Ritz*,⁷ the Supreme Court settled this dispute, holding that actual fraud does not require a misrepresentation to the creditor.⁸ The Court thereby created the option of recovery for creditors under Section 523(a)(2)(A) even where they had not been directly lied to, as long as the debtor still implemented actual fraud in relation to its debt.⁹

The Supreme Court came to the right decision in its holding in *Husky*, but it also opened the door to creditor recovery under Section 523(a)(2)(A) in situations where a debtor might be innocent but vulnerable.¹⁰ This overly wide net is a result of “badges of fraud,” a set of objective factors courts and state legislatures have used to evaluate fraud in bankruptcy.¹¹ When taken in aggregate, badges of fraud indicate that a debtor was fraudulent, but they could also be present due to circumstances completely unrelated to fraud.¹² To remedy this disconnect between the intentional fraud that Congress meant to prevent with Section 523(a)(2)(A) and the types of debtors that can now be held liable under it, Congress should enact a new pleading standard similar to that used in securities litigation.¹³ Private securities litigants must plead a “strong inference” of fraudulent intent,¹⁴ which places more responsibility on judges and juries to determine whether the debtor had intent to act fraudulently, rather than unwittingly meeting a list of “badges of fraud.”¹⁵ A “strong inference” pleading standard would

5. See *infra* Part I; see also *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1586 (2016) (“Although ‘fraud’ connotes deception or trickery generally, the term is difficult to define more precisely.”).

6. See generally *Field v. Mans*, 516 U.S. 59 (1995) (holding that a creditor must justifiably rely on a debtor’s representation for that debt to be excepted from discharge under Section 523(a)(2)(A)); *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) (holding that actual fraud under Section 523(a)(2)(A) is not limited to misrepresentations); *In re Lawson*, 791 F.3d 214 (1st Cir. 2015) (holding that actual fraud under Section 523(a)(2)(A) is broader than misrepresentations).

7. 136 S. Ct. 1581 (2016).

8. *Id.* at 1590.

9. *Id.*

10. See *infra* Part II.B.

11. See, e.g., TEX. BUS. & COM. CODE ANN. § 24.005 (West 1987) (integrating badges of fraud into its exception to discharge statute).

12. Brief of Amicus Curiae The National Association of Consumer Bankruptcy Attorneys in Support of the Respondent, Daniel Lee Ritz, Jr. at 5, *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581 (2016) (No. 15-145), [hereinafter Bankruptcy Attorneys’ Brief] (“Every constructive fraudulent conveyance will too readily become recast as ‘actual fraud’ . . .”).

13. See *infra* Part II.C.

14. 15 U.S.C. § 78u-4(b)(2)(A) (2012).

15. See *infra* Part II.C.3.

reduce instances of litigation abuse and clearly set the tone of Congress's objectives for its inclusion of "actual fraud" in Section 523(a)(2)(A).¹⁶

I. BACKGROUND

This Part will discuss the development of the term "actual fraud" and its meaning under Section 523(a)(2)(A). First, it will look at common law interpretations of "actual fraud," which the Supreme Court relied upon in *Husky*.¹⁷ Second, it will examine Congress's purpose in adding actual fraud to Section 523(a)(2)(A) of the Bankruptcy Reform Act of 1978.¹⁸ Next, it will highlight the differences in interpretation among the Federal Courts of Appeals as to the meaning of actual fraud and its place in Section 523(a)(2)(A).¹⁹ Finally, it will summarize the *Husky* case, its procedural background, and the reasoning of the Supreme Court in deciding that actual fraud does not require a misrepresentation.²⁰

A. *The Evolution of "Actual Fraud" in Bankruptcy Cases at Common Law*

Actual fraud is a "common-law term."²¹ The Supreme Court traditionally interprets common law terms to "imply elements that the common law has defined them to include."²² American bankruptcy law has, since its beginning, drawn on Statute of 13 Elizabeth, written in England during the sixteenth century.²³ In relevant part, Statute of 13 Elizabeth "invalidate[s] 'covinous and fraudulent' transfers designed 'to delay, hinder or defraud creditors and others.'"²⁴ Most American bankruptcy and fraudulent transfer statutes are modeled after Statute of 13 Elizabeth because they include a "fraudulent transfer" exception to discharge.²⁵ Because fraudulent transfer exceptions to discharge have been a

16. *Id.*

17. *See infra* Part I.A.

18. *See infra* Part I.B.

19. *See infra* Part I.C–D.

20. *See infra* Part I.E–F.

21. *Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1586–88 (2016) (discussing how common law has defined "actual" and "fraud" to arrive at a common law meaning of "actual fraud").

22. *Field v. Mans*, 516 U.S. 59, 69 (1995).

23. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994).

24. *Id.* (quoting 13 Eliz., ch. 5 (1570)).

25. *Boston Trading Grp., Inc. v. Burnazos*, 835 F.2d 1504, 1505–06 (1st Cir. 1987); *see, e.g.*, MASS. GEN. LAWS ch. 109A, § 3 (1996) (replicating Statute of 13 Elizabeth's language in its fraudulent transfer statute).

fundamental piece of bankruptcy law from the start, the Supreme Court has generally relied on Statute of 13 Elizabeth as an interpretive guide.²⁶

Actual fraud was further defined in *Neal v. Clark*²⁷ in 1877. The Supreme Court in *Neal* held that the defendant was not guilty of “actual fraud” because he “[did] not show that he entertained any purpose himself to commit a fraud, or to aid . . . in committing one.”²⁸ The Court found that actual fraud, unlike constructive fraud, includes behavior “involving moral turpitude or intentional wrong,” such as embezzlement.²⁹ *Neal* suggests that actual fraud is not a question of merely the *actus reus*.³⁰ It requires *mens rea* and is distinct from constructive fraud.³¹ *Neal* is crucial to the interpretation of “actual fraud” in this context because it was the blueprint for Section 523(a)(2)(A).³²

Many courts, when interpreting a statute’s common law terms, look to the Restatement of the statute’s respective area of law as a reference point for the term’s general common law meaning.³³ When Congress amended Section 523(a)(2)(A) of the Bankruptcy Reform Act of 1978, the Restatement (Second) of Torts defined fraudulent misrepresentations.³⁴ It did not, however, reference the term “actual fraud.”³⁵

26. *Husky*, 136 S. Ct. at 1587.

27. 95 U.S. 704 (1877).

28. *Id.* at 707.

29. *Id.* at 709.

30. *Id.* at 707 (discussing that the defendant “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.”).

31. *Id.* at 709 (explaining that “fraud” in the statute at issue meant “positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality.”).

32. 124 CONG. REC. 33,998 (1978) (“Subparagraph (A) [of § 523] is intended to codify current case law *e.g.*, *Neal v. Clark*, which interprets ‘fraud’ to mean actual or positive fraud rather than fraud implied in law.” (citation omitted) (citing *Neal v. Clark*, 95 U.S. 704 (1887)).

33. Restatements are “influential treatises published by the American Law Institute describing the law in a given area and guiding its development” which are “frequently cited in cases and commentary.” *Restatement*, BLACK’S LAW DICTIONARY (10th ed. 2014).

34. RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW. INST. 1977) (defining fraudulent misrepresentation as “mak[ing] a misrepresentation of fact, opinion, intention, or law for the purpose of inducing another to act or refrain from action in reliance upon it”).

35. *See generally id.* Because the Court did not have a clear *Restatement* definition to work with when interpreting what “actual fraud” meant in *Husky*, it had to look into other common law sources, such as Statute of 13 Elizabeth, and employ other canons of construction, such as the section’s syntax, to discern the meaning of the term. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1586–88 (2016).

B. The Legislative History of the Bankruptcy Reform Act of 1978 and Its Implications for the Court's Interpretation of Section 523(a)(2)(A)

In 1978, Congress passed the Bankruptcy Reform Act of 1978 to amend the Federal Bankruptcy Code.³⁶ According to the Court, “[w]hen Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.”³⁷ Before the Bankruptcy Reform Act, Section 523(a)(2)(A) included “false pretenses” and “false representations.”³⁸ The term “actual fraud” was “added as a ground for exception from discharge” during the amendment process.³⁹ Congress noted the potential for abuse of Section 523(a)(2)(A) by creditors, but still reinforced their position that debts obtained by “false pretenses, false representations, or actual fraud” should be excepted from discharge.⁴⁰ Congress’s purpose was not to limit the types of “actual fraud” that could be brought as an exception.⁴¹

C. The Court Interpreted Section 523(a)(2)(A) Narrowly in Field v. Mans

In *Field v. Mans*,⁴² a Supreme Court case from 1995, the plaintiffs were actively misled by defendant through a letter asking them to waive their right of sale on their real estate property, after defendant had already sold the property without plaintiffs’ consent.⁴³ The Court in *Field* held that the plaintiffs needed to show justifiable reliance on a debtor’s misrepresentation for the debt to be excepted from discharge under Section 523(a)(2)(A).⁴⁴ That was the extent of the Court’s holding.⁴⁵ The Court did not consider whether a misrepresentation was necessary for eligibility for exception from discharge under Section 523(a)(2)(A); the Court only

36. S. REP. NO. 95-989 (1978).

37. *Stone v. I.N.S.*, 514 U.S. 386, 397 (1995) (citations omitted) (citing *Moskal v. United States*, 498 U.S. 103, 109–11 (1990); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979)).

38. S. REP. NO. 95-989, at 78 (1978).

39. *Id.*

40. *Id.*

41. *Id.* Congress wanted exceptions from discharge where “discharge would violate the bankruptcy objective of giving a fresh start only to honest debtors,” including fraud. H.R. REP. NO. 102-1085, 102nd Cong., at 50–51 (1992).

42. 516 U.S. 59 (1995).

43. *Id.* at 61–62.

44. *Id.* at 61.

45. *Id.* at 78 (Ginsburg, J., concurring) (discussing how the only issue resolved was the level of reliance and that the court did not take up any causation questions once it resolved the level of reliance needed).

considered the level of reliance a creditor must put on a misrepresentation, if there was one, for the debt to be excepted from discharge.⁴⁶

In a concurring opinion, Justice Ginsburg recognized the limits of the Court's holding in *Field* and foreshadowed the uncertainties of Section 523(a)(2)(A) that would later be at issue in *Husky*.⁴⁷ She expressly stated that the Court, in *Field*, had only answered the question of the necessary level of reliance on a misrepresentation when the creditor's claim is based upon a misrepresentation.⁴⁸ She concluded that the "unsettled causation" issue is not resolved and must be decided in another case.⁴⁹

D. The Seventh and First Circuits Interpret Section 523(a)(2)(A) as Not Requiring a Misrepresentation for Actual Fraud

Five years after the Supreme Court heard *Field v. Mans*, federal appellate courts began deciding cases involving the "unsettled causation" issues, as Justice Ginsburg anticipated.⁵⁰ In *McClellan v. Cantrell*,⁵¹ the Seventh Circuit held that "actual fraud" is "not limited to misrepresentations and misleading omissions."⁵² It gave weight to the fact that Congress added "actual fraud" into the statute during the Bankruptcy Reform Act, concluding that, "by distinguishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation."⁵³

The First Circuit heard a similar case, *In re Lawson*,⁵⁴ at the same time the Supreme Court heard *Husky*.⁵⁵ The First Circuit, like the Seventh Circuit, held that "'actual fraud' under [Section] 523(a)(2)(A) is not limited to fraud effected by misrepresentation."⁵⁶ The court found that the "fraud"

46. *Id.* at 73–75 (holding narrowly that "[Section] 523(a)(2)(A) requires justifiable, but not reasonable, reliance" and vacating and remanding the case for the lower court to evaluate plaintiffs' reliance on defendants' misrepresentation using a justifiable reliance standard).

47. *Id.* at 78–79.

48. *Id.*

49. *Id.*

50. See, e.g., *In re Lawson*, 791 F.3d 214 (1st Cir. 2015); *In re Ritz*, 787 F.3d 312 (5th Cir. 2015); *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000).

51. *McClellan*, 217 F.3d 890.

52. *Id.* at 893.

53. *Id.* The bankruptcy court that heard *McClellan* before its appeal to the Seventh Circuit read *Field v. Mans* to mean that a debt could not be excepted from discharge without a "showing of material misrepresentation and reliance on the statement." *Id.* at 892. The Seventh Circuit disagreed with this interpretation because, as noted by Justice Ginsburg, *Field* dealt only with "the nature of the reliance that a plaintiff must show to prove fraud in [a Section 523(a)(2)(A)] case." The Seventh Circuit concluded that "*Field* has nothing to do with this case." *Id.*

54. 791 F.3d 214 (1st Cir. 2015).

55. *Id.*

56. *Id.* at 220.

definition in the *Restatement of Torts* dealt with fraud broader than just misrepresentations, including “fraudulent interference with property rights.”⁵⁷ It also relied on *Collier on Bankruptcy*, a leading bankruptcy treatise, which provides, “[a]ctual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.”⁵⁸ By using these common law sources, the First Circuit aligned itself with the Seventh Circuit.⁵⁹

E. Lower Court Decisions in Husky International Electronics, Inc. v. Ritz

In *In re Ritz*,⁶⁰ the case that would ultimately become *Husky International Electronics, Inc. v. Ritz*, the Fifth Circuit reached the opposite conclusion of the First and Seventh Circuit regarding the misrepresentation question.⁶¹ It found that, for a debt to be excepted from discharge under Section 523(a)(2)(A), there must be a misrepresentation and actual fraud does not include any fraudulent acts other than misrepresentation for the purpose of Section 523(a)(2)(A).⁶² To fully appreciate the scope of the issue presented in *Husky*, a detailed discussion of the case at issue follows.

Defendant Daniel Lee Ritz Jr. (“Ritz”) was a director of Chrysalis Manufacturing Corp. (“Chrysalis”).⁶³ He was also in financial control of Chrysalis and owned at least thirty percent of its common stock during the relevant period.⁶⁴ The plaintiff, Husky International Electronics, Inc. (“Husky”), contracted to sell and deliver electronic device components to Chrysalis, and transacted with Chrysalis from 2003 through 2007.⁶⁵ Chrysalis failed to pay Husky for \$163,999 worth of components.⁶⁶ Husky sued Chrysalis to recover that debt in May of 2009.⁶⁷ Unfortunately for

57. *Id.* at 219 (citing RESTATEMENT (SECOND) OF TORTS, index, “Fraud” (AM. LAW INST. 1977); RESTATEMENT (SECOND) OF TORTS § 871 (AM. LAW INST. 1977)).

58. *Id.* (quoting 4 COLLIER ON BANKRUPTCY ¶ 523.08(1)(e) (Alan A. Resnick & Henry J. Sommer eds., 16th ed. 2015)).

59. *Id.* at 216 n.1.

60. 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).

61. *Id.* at 321 (“For all of these reasons, we conclude that a representation is a necessary prerequisite for a showing of ‘actual fraud’ under Section 523(a)(2)(A).”).

62. *Id.*

63. *In re Ritz*, 459 B.R. 623, 626 (Bankr. S.D. Tex. 2011), *aff’d*, 513 B.R. 510 (S.D. Tex. 2014), *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), *vacated and remanded sub nom.* *In re Ritz*, No. 14-20526, 2016 WL 4253552 (5th Cir. Aug. 10, 2016).

64. *Id.* at 627.

65. *Id.*

66. *Id.*

67. *In re Ritz*, 513 B.R. at 523–24.

Husky, Ritz transferred hundreds of thousands of dollars of Chrysalis's assets to seven other companies, which he also controlled, between November of 2006 and May of 2007, and ignored Chrysalis's debts.⁶⁸ After Husky sued to recover its debts, Ritz filed for Chapter 7 bankruptcy.⁶⁹ Husky filed an adversary proceeding to Ritz's bankruptcy claim to recover the \$163,999 owed by Chrysalis, hoping to pierce the corporate veil and hold Ritz personally liable for Chrysalis's debts.⁷⁰

This case began in Bankruptcy Court in the Southern District of Texas in 2011, where Ritz's bankruptcy case was "routine" until Husky filed its adversary proceeding.⁷¹ Husky pursued several different routes to recover its debts.⁷² The bankruptcy court quickly dismissed Husky's attempt to recover under Section 523(a)(4), an exception to discharge limited to parties with a fiduciary relationship, which did not apply because there was no fiduciary relationship between the parties.⁷³ The second route and the true area of contention in this case was whether Ritz's fraudulent transfer of Chrysalis's assets to his other companies fell within the scope of the meaning of "actual fraud" in Section 523(a)(2)(A).⁷⁴ The Bankruptcy Court found that Husky could not recover under Section 523(a)(2)(A) because, according to Texas law, "actual fraud" requires a false representation intended to induce the creditor to enter into a debt agreement.⁷⁵ Because there was no evidence of a representation made by Ritz to induce Husky to enter into the contract, Husky could not recover under the "actual fraud" language in Section 523(a)(2)(A).⁷⁶

68. *In re Ritz*, 459 B.R. at 628.

69. *Id.* at 627.

70. *Id.* Adversary proceedings include, among other things, actions "to determine the dischargeability of a debt" or "to object to or revoke a discharge." FED. R. BANKR. P. 7001. "Piercing the corporate veil" refers to the principle that "the corporate veil may be pierced and the [owner] held liable for the corporation's conduct when . . . the corporate form would otherwise be misused to accomplish certain wrongful purposes, most notably fraud, on the shareholder's behalf." *United States v. Bestfoods*, 524 U.S. 51, 52 (1998). According to current case law, the Texas Business Organizations Code ("TBOC") allows for the corporate veil to be pierced if "(1) the corporation is the alter ego of its owners and/or shareholders; (2) the corporation is used for illegal purposes; and (3) the corporation is used as a sham to perpetrate a fraud" and "the defendant shareholder '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.'" *In re Ritz*, 459 B.R. at 632 (quoting *Rimade Ltd. v. Hubbard Enters. Inc.*, 388 F.3d 138, 143 (5th Cir. 2004)).

71. *In re Ritz*, 459 B.R. at 627.

72. *Id.* at 632–33.

73. *Id.* at 633.

74. *Id.* at 632–33.

75. *Id.* at 633.

76. *Id.*

Husky appealed to the U.S. District Court for the Southern District of Texas, which affirmed the decision of the bankruptcy court.⁷⁷ Slightly straying from the bankruptcy court's course of logic, the district court acknowledged that there are cases where a party can pierce the corporate veil because of actual fraud without a misrepresentation.⁷⁸ The district court did not find that there was actual fraud, however.⁷⁹ Instead, it followed the canon of construction that a statute created by Congress must be interpreted according to its common law meaning.⁸⁰ In this case, the district court relied on *The Restatement (Second) of Torts*.⁸¹ *The Restatement (Second) of Torts* only references fraudulent misrepresentation, not actual fraud.⁸² The district court, therefore, held that a misrepresentation was necessary to show actual fraud.⁸³ Because Husky provided no evidence of a misrepresentation, the court concluded, Ritz could discharge its debt.⁸⁴ Husky appealed to the Fifth Circuit.⁸⁵

The Fifth Circuit affirmed the decisions of the bankruptcy and district courts.⁸⁶ The Fifth Circuit held that Congress did not intend for fraudulent transfers to fall within the scope of "actual fraud" in Section 523(a)(2)(A) because another provision of the Bankruptcy Code, Section 727(a)(2), prohibits discharge of debt involving fraudulent transfers, and statutes should be construed to avoid redundancy.⁸⁷ The Fifth Circuit acknowledged its decision was in conflict with the Seventh Circuit's decision in *McClellan v. Cantrell*, which expanded the interpretation of "actual fraud" to include fraudulent transfers.⁸⁸ It contended, however, that *McClellan* contradicted the Supreme Court's decision in *Field v. Mans*.⁸⁹ Finally, the Fifth Circuit felt it was important to honor the purpose of bankruptcy law, which is to give the debtor a clean start.⁹⁰ To achieve this,

77. *In re Ritz*, 513 B.R. 510, 517 (S.D. Tex. 2014), *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), *vacated and remanded sub nom. In re Ritz*, No. 14-20526, 2016 WL 4253552 (5th Cir. Aug. 10, 2016).

78. *Id.* at 537.

79. *Id.* at 538.

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.* at 539.

85. *In re Ritz*, 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), *vacated and remanded sub nom. In re Ritz*, No. 14-20526, 2016 WL 4253552 (5th Cir. Aug. 10, 2016).

86. *Id.* at 314.

87. *Id.* at 320–21.

88. *Id.* at 317.

89. *Id.*

90. *Id.* at 321.

courts should err on the side of giving debtors the opportunity to start anew when considering an ambiguity in the statute.⁹¹ Recognizing the need to resolve the circuit split regarding the issue of “actual fraud,” the Supreme Court granted Husky’s petition for certiorari.⁹²

F. The Supreme Court’s Reasoning in Husky International Electronics, Inc. v. Ritz

In *Husky International Electronics, Inc. v. Ritz*, the Supreme Court reversed the Fifth Circuit’s decision, holding that the term “actual fraud” in Section 523(a)(2)(A) of the Bankruptcy Code includes schemes like fraudulent transfers where no misrepresentation is involved.⁹³ The Court first analyzed the meaning of “actual fraud” under the common law, then interpreted it within the context of the rest of the Bankruptcy Code.⁹⁴ It concluded that neither the common law nor the Bankruptcy Code precludes actual fraud from including fraudulent transfer schemes or other types of fraud without misrepresentations.⁹⁵

The Court relied on the general principle that the judiciary interprets statutes based upon their common law meanings, so the Court split up the term “actual fraud” into “actual” and “fraud” in an effort to discern the most accurate common law meaning for the term.⁹⁶ In the fraud context, “actual,” in contrast with “constructive,” refers to behavior that “involv[es] moral turpitude or intentional wrong.”⁹⁷ As for “fraud,” bankruptcy common law has always recognized the transfer of assets to impede a creditor’s ability to collect its debts as “fraud.”⁹⁸ The Court referred to Statute of 13 Elizabeth, which it described as deeply influential in modern bankruptcy law, to show the long-standing concept that transfers to hide assets from creditors is fraud.⁹⁹ The Court also noted that common law indicates that fraudulent transfers do not require a misrepresentation to be considered fraud.¹⁰⁰ In this case, the Court noted that the common law reflects common sense because the wrongfulness of a fraudulent transfer like Ritz’s is not in the inducement to enter into a contract, but in the

91. *Id.*

92. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1585 (2016).

93. *Id.* at 1590.

94. *Id.* at 1586–89.

95. *Id.* at 1590.

96. *Id.* at 1586.

97. *Id.* (quoting *Neal v. Clark*, 95 U.S. 704, 709 (1878)).

98. *Id.* (noting that the historical meaning of “actual fraud” has included within its scope “a transfer scheme designed to hinder the collection of debt”).

99. *Id.* at 1587.

100. *Id.* (“[T]he common law also indicates that fraudulent conveyances, although a ‘fraud,’ do not require a misrepresentation from a debtor to a creditor.”).

secrecy of hiding assets.¹⁰¹ Opportunities for representations are limited in a fraudulent transfer, so representations are not a “defining feature of this type of fraud.”¹⁰²

After the Court determined that the common law does not exclude fraudulent conveyances from “actual fraud,” it examined how “actual fraud” under Section 523(a)(2)(A) fits into the scheme of the Bankruptcy Code and whether construing “actual fraud” broadly to include fraudulent transfers was logical under the statutory scheme.¹⁰³ The defendant contended that that interpreting “actual fraud” to include fraudulent conveyances would be duplicative of other provisions in the bankruptcy code; namely Sections 523(a)(4), 523(a)(6), or 727(a)(2).¹⁰⁴ The Court discussed meaningful differences between Section 523(a)(2)(A) and these other sections, and concluded that, just because the provisions cover transfers or conveyances does not make them redundant.¹⁰⁵ For example, Section 523(a)(4) only covers fraud while acting as a fiduciary, while 523(a)(2)(A) has no such limitations.¹⁰⁶ Section 523(a)(6) covers willful and malicious injury, regardless of whether the injury was a result of fraud; Section 523(a)(2)(A) only covers fraudulent acts.¹⁰⁷ Section 727(a) is broader than Section 523(a)(2)(A) in that it prevents a debtor from discharging all debts, but narrower because it limits the fraudulent time frame of relevance to one year.¹⁰⁸ The separate sections of the statute all have meaningful differences, indicating that recognition of fraudulent transfers under Section 523(a)(2)(A) would not be redundant.¹⁰⁹

The defendant also argued that Section 523(a)(2)(A) cannot include conveyances because it is limited to debt “obtained by” fraud, and in a fraudulent conveyance, the debt is already possessed.¹¹⁰ The Court declined to follow this argument based on two cases. First, it cited *McClellan v. Cantrell* for the proposition that a third party who receives assets from a fraudulent transfer is someone who “obtained” debt by fraud, which leads to the conclusion that the “obtained by” language is not “wholly incompatible” with fraudulent transfers.¹¹¹ Then, the Court disputed the

101. *Id.* (“In such cases, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the acts of concealment and hindrance.”).

102. *Id.*

103. *Id.* at 1588–89.

104. *Id.*

105. *Id.*

106. *Id.* at 1588.

107. *Id.*

108. *Id.* at 1588–89.

109. *Id.*

110. *Id.* at 1589.

111. *Id.*

defendant's reliance upon *Field v. Mans*, which the defendant cited as support for the rule that actual fraud must relate to the "inception of a credit transaction."¹¹² The Court distinguished the rule created in *Field*, because it only applies where fraud is perpetrated by a misrepresentation to a creditor, not in all cases under Section 523(a)(2)(A).¹¹³

The Court concluded by discrediting the defendant's final argument: that Congress intended the phrase "or actual fraud" to mean "by actual fraud."¹¹⁴ The Court noted that Ritz's statutory interpretation argument was unprecedented and would not work in this situation.¹¹⁵ After rejecting all of the defendant's interpretive hurdles obstructing fraudulent conveyance's inclusion in "actual fraud," the Court concluded that fraudulent conveyances are within the scope of Section 523(a)(2)(A) and reversed and remanded the case.¹¹⁶

Justice Thomas, the lone dissenter in *Husky*, believed that the "obtained by" language was meant by Congress to be an important limitation on the scope of Section 523(a)(2)(A) and argued that the majority improperly broadened the reach of the statute.¹¹⁷ He did not consider the "reliance" standard set forth in *Field* to be distinguishable from the case at hand.¹¹⁸ He argued that "actual fraud" "subsumes 'false pretenses' and 'false representations,'" and should therefore not be considered a separate cause of action.¹¹⁹ He concluded that if Congress had wanted a debtor to be prohibited from discharging debt concealed through a fraudulent conveyance, it would have written that language into the statute.¹²⁰ Because Congress chose not to write this into the statute, Justice Thomas believed that the majority was overstepping its boundaries and into legislative territory by over-broadening the meaning of Section 523(a)(2)(A).¹²¹

II. ANALYSIS

This Part will first discuss why the Supreme Court was correct in holding that actual fraud does not require a misrepresentation by a debtor to

112. *Id.*

113. *Id.*

114. *Id.* at 1590.

115. *Id.*

116. *Id.*

117. *Id.* at 1590–94 (Thomas, J., dissenting). The majority dispelled this argument by noting that "[n]othing in the text of § 523(a)(2) supports that additional requirement." *Id.* at 1589 (majority opinion).

118. *Id.* at 1592–93 (Thomas, J., dissenting).

119. *Id.* at 1593.

120. *Id.* at 1593–94.

121. *Id.* at 1594.

its creditor.¹²² Next, it will posit that, while the Supreme Court was correct, its holding will apply to cases beyond Congress's intended scope for Section 523(a)(2)(A) because of deficiencies inherent in the "badges of fraud" approach used by courts to evaluate fraudulent intent.¹²³ It will then consider the need for a new standard of fraud and draw parallel objectives between Section 523(a)(2)(A) and the Private Securities Litigation Reform Act ("PSLRA").¹²⁴ Finally, it will suggest that courts and legislatures should adopt the PSLRA's "strong inference" of fraudulent intent pleading standard as the solution to the weaknesses using badges of fraud creates.¹²⁵

A. *The Supreme Court Decided the "Actual Fraud" Debate Correctly*

The *Husky* Court examined a very narrow issue: whether "actual fraud" under Section 523(a)(2)(A) is limited to misrepresentations.¹²⁶ The Court correctly found that actual fraud is not limited to misrepresentation. First, the common law, which Congress intended to codify by enacting the Bankruptcy Reform Act of 1978, never limited actual fraud to misrepresentations.¹²⁷ Second, according to statutory canons of construction, "or" phrases should be treated as expansive, rather than limiting.¹²⁸ Third, limiting "actual fraud" to misrepresentations would allow debtors to discharge themselves of debt in ways that Congress did not intend.¹²⁹

1. *Common Law Meaning of "Actual Fraud" and Legislative Intent*

Most American law regarding fraudulent conveyances can trace its roots to Statute of 13 Elizabeth,¹³⁰ which recognized fraudulent conveyances as activity done with intent to delay, hinder or defraud.¹³¹ Because Statute of 13 Elizabeth has influenced so many American fraudulent conveyance statutes,¹³² it is a reasonable touchstone for a common law definition of fraud.¹³³

122. *See infra* Part II.A.

123. *See infra* Part II.B.

124. *See infra* Part II.C; 15 U.S.C. § 78u-4 (2012).

125. *See infra* Part II.C.3–5.

126. *Husky*, 136 S. Ct. at 1585 (majority opinion).

127. *See infra* Part II.A.1.

128. *See infra* Part II.A.2.

129. *See infra* Part II.A.3.

130. *See supra* notes 23–26 and accompanying text.

131. *Husky*, 136 S. Ct. at 1587.

132. *See* PETER A. ALCES, LAW OF FRAUDULENT TRANSACTIONS § 5:32, Westlaw (database updated Aug. 2016) (discussing how both the Uniform Fraudulent Conveyances Act and Uniform

Congress, when enacting the Bankruptcy Reform Act of 1978, intended for Section 523(a)(2)(A) to “codify current case law *e.g.*, *Neal v. Clark*, which interprets ‘fraud’ to mean actual or positive fraud rather than fraud implied in law.”¹³⁴ Congress was not concerned with limiting “fraud” to misrepresentation, but rather wanted to ensure that the statute penalized the correct level of intent.¹³⁵ Because the common law meaning of “actual fraud” logically includes fraudulent conveyances¹³⁶ and Congress did not intend to limit Section 523(a)(2)(A) to misrepresentations,¹³⁷ the Supreme Court correctly found that the term “actual fraud” could include fraudulent conveyances.

2. *Cannons of Construction*

There are two canons of construction used in statutory interpretation that further support the argument that the Supreme Court was accurate in its interpretation of Section 523(a)(2)(A). First, courts should not render any terms in the statute as surplusage.¹³⁸ That is, “a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word will be superfluous, void, nugatory, or insignificant.”¹³⁹ Because Congress specifically added the term “or actual fraud” in 1978¹⁴⁰ and the term “misrepresentation” precedes “actual fraud” in a disjunctive list,¹⁴¹ if the Court had found “actual fraud” to be limited to misrepresentations, it would have rendered the phrase “or actual fraud” to be superfluous.

Fraudulent Transfer Act, along with several state fraudulent transfer statutes, have incorporated language from Statute of 13 Elizabeth).

133. *Husky*, 136 S. Ct. at 1587.

134. 124 CONG. REC. 33,998 (1978) (citation omitted) (citing *Neal v. Clark*, 95 U.S. 704 (1887)).

135. *See supra* note 31 and accompanying text (noting the reason for including actual fraud was to capture actions perpetrated with “moral turpitude or intentional wrong”).

136. Marie T. Reilly, *The Latent Efficiency of Fraudulent Transfer Law*, 57 LA. L. REV. 1213, 1216 (1997) (discussing how actual fraud and fraudulent transfer law both have their roots in Statute 13 of Elizabeth).

137. Congress’s choice to say it “added” actual fraud to 523(a)(2)(A), rather than saying it was using actual fraud to clarify or limit false pretenses or false representations, suggests that actual fraud is a different cause of action than false pretenses or false representation. *See* S. REP. NO. 95-989, at 78 (1978) (discussing that the provision excepting discharge where the debtor used false pretenses or false representations has been “modified only slightly” as “actual fraud is added as a ground for exception from discharge”).

138. 82 C.J.S. *Statutes* § 433 (2016).

139. *Id.*

140. S. REP. NO. 95-989, at 78 (1978) (“[A]ctual fraud’ is added as a ground for exception from discharge.”).

141. 11 U.S.C. § 523(a)(2)(A) (2012). A disjunctive list “express[es] an alternative or opposition between the meanings of the words connected.” *Disjunctive*, MERRIAM-WEBSTER DICTIONARY (2017).

The second relevant canon of construction is the meaning of the disjunctive article “or.” “Or” is used to signify that “only one of the listed requirements need be satisfied.”¹⁴² This suggests that when Congress added “or actual fraud” to Section 523(a)(2)(A), it meant to expand the exceptions to discharge to include “actual fraud,” and not to limit the scope of the provision, as Justice Thomas suggested in his dissent.¹⁴³ While some states did away with the distinction between “and” and “or,” there is generally no need to read a different meaning into an article unless it is necessary for the statute to reach its intended purpose.¹⁴⁴ In Section 523(a)(2)(A), there is no need to read “or” to mean “and” or “by,” because Congress’s goal was to add actual fraud as a ground for exception to discharge.¹⁴⁵

3. Consequences of Limiting “Actual Fraud” to Misrepresentations

The purpose of the Federal Bankruptcy Reform Act, as mentioned above, is to balance the interests of debtors who need a fresh start and creditors who are rightfully owed repayment on their loans.¹⁴⁶ Congress, in enacting the Bankruptcy Reform Act, has created numerous exceptions to discharge where it finds the debtors are not entitled to a fresh start because of the debtors’ conduct.¹⁴⁷ Congress could not have intended, when writing the Bankruptcy Reform Act, to allow debtors to escape fulfilling their obligations merely by moving their assets, as defendant Ritz did.¹⁴⁸ If the Supreme Court had resolved *Husky* on different grounds, however, it would have been condoning such behavior.¹⁴⁹ While Ritz argued that it would be redundant for Section 523(a)(2)(A) to be read this way when Section 727(a)(2) exists,¹⁵⁰ creditors need a remedy for fraudulent transfers occurring outside of the year before the debtor filed for bankruptcy, as was

142. LARRY M. EIG, CONG. RESEARCH SERV., 7-5700, STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS 9 (2011), <https://www.fas.org/sgp/crs/misc/97-589.pdf>.

143. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1590–94 (2016) (Thomas, J., dissenting); see also *supra* notes 117–118 and accompanying text (discussing Justice Thomas’s dissenting opinion).

144. See generally Jacob Scott, *Codified Canons and the Common Law of Interpretation*, 98 GEO. L.J. 341, 358 n.80, 360 (2010) (noting that “or” should be used in its disjunctive meaning unless the context of a statute clearly indicates otherwise).

145. See *supra* note 137.

146. See *Understanding Bankruptcy*, *supra* note 1.

147. See, e.g., 11 U.S.C. §§ 523, 727, 1228(a), 1228(b), 1328(b) (2012).

148. *Experts Discuss Supreme Court’s Ruling in Husky International Electronics Inc. v. Ritz and Its Impact on Fraudulent Conveyance Litigation*, AM. BANKR. INST. (Dec. 18, 2016) [hereinafter *Experts Discuss Husky*], <http://www.abi.org/educational-brief/experts-discuss-supreme-courts-ruling-in-husky-international-electronics-inc-v>.

149. *Id.*

150. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1588–89 (2016).

the case in *Husky*. Otherwise, creditors that extended credit years prior to a debtor filing bankruptcy, but who still rightfully expect to be repaid, would have no remedy. Congress likely did not intend to permit discharge of debt related to fraudulent transfers simply because the debtor found a loophole.¹⁵¹

B. Section 523(a)(2)(A), As Interpreted By Husky, Is Too Broad

1. Badges of Fraud

Though the Supreme Court was correct in its decision that actual fraud is not limited to misrepresentations, concern over whether Section 523(a)(2)(A) will become too far-reaching is well founded.¹⁵² Lower courts are starting to adopt *Husky* as precedent for fraudulent transfer bankruptcy cases beyond the Court's narrow decision.¹⁵³ Had the Court decided that actual fraud was limited to misrepresentations, there would be a bright line test to determine whether a debtor's actions fell under Section 523(a)(2)(A), because a misrepresentation, by its nature, is an affirmative fraudulent act, done to a specific creditor.¹⁵⁴ If the actual fraud involved is a fraudulent transfer rather than a misrepresentation, as in *Husky*, then one could argue that all of a debtor's creditors are affected in the same way because the transfer has removed that amount of assets from the bankruptcy estate as a whole, disadvantaging all creditors.¹⁵⁵

Reservations about *Husky* are valid, not because actual fraud is broader than some circuits believed, but because of the common law standard of deciding whether a conveyance was fraudulent.¹⁵⁶ Many state fraudulent transfer statutes, as well as the Federal Bankruptcy Reform Act, rely on circumstantial evidence referred to as "badges of fraud" to decide whether a

151. Andrew L. Van Houter, *Reopening the Loophole: Avoiding Securities Fraud Debt Through Bankruptcy*, 42 SETON HALL L. REV. 1713, 1716 (2012) ("The underpinning of [bankruptcy policy] is obvious; Congress created the discharge to give the honest debtor a fresh start, but the dishonest debtor deserves no such protection.").

152. Many experts think *Husky* "creates a lot more problems than it solves." Diane Davis, *High Court's Husky Is 'Narrow,' Leaves Unanswered Questions*, 28 BLOOMBERG BANKR. L. REP. 671, 671 (2016); see also *Experts Discuss Husky*, *supra* note 148 (discussing bankruptcy expert Professor G. Eric Brunstad Jr.'s reservations on the Supreme Court's decision in *Husky*).

153. See, e.g., *In re Thompson*, 555 B.R. 1, 10 (B.A.P. 10th Cir. 2016) (expanding on issues unresolved by *Husky* and stating, "there is no requirement that a creditor rely on the actual fraud" or "that the debtor's actual fraud induced the creditor").

154. *Experts Discuss Husky*, *supra* note 148 (opining that for actual fraud to be tied to a particular debt there should be a nexus between the two, i.e. a misrepresentation).

155. *Id.* (Professor Casey, a supporter of the Supreme Court's decision in *Husky*, admitting that other creditors of Chrysalis could have mounted a similar claim to *Husky*'s based on the Court's decision).

156. See *infra* notes 166–167 and accompanying text.

transferor transferred his assets fraudulently.¹⁵⁷ If multiple badges of fraud are established, a rebuttable presumption that the defendant was fraudulent arises.¹⁵⁸ Rebutting a presumption based upon broad generalizations can disadvantage vulnerable debtor defendants.¹⁵⁹ As an example, this Comment will use Texas's Business and Commerce Code, which has adopted the Uniform Fraudulent Transfer Act (UFTA), to demonstrate the breadth of badges of fraud and consequences that arise from using them.¹⁶⁰

The statute considers whether:

- (1) the transfer or obligation was to an insider;
- (2) the debtor retained possession or control of the property transferred after the transfer;
- (3) the transfer or obligation was concealed;
- (4) before the transfer was made or obligation was incurred, 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 or the amount of the obligation incurred;
- (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
- (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.¹⁶¹

The true purpose of excepting a debtor from discharge is to remove bankruptcy's protections from one who intentionally remove assets from her creditor's reach.¹⁶² In situations where debtors are vulnerable, however, the badges of fraud, listed above, are overly broad.¹⁶³ While *Neal v. Clark* intended "actual fraud" to exclude "constructive fraud" and only include

157. See, e.g., TEX. BUS. & COM. CODE ANN. § 24.005 (West 1987); N.C. GEN. STAT. ANN. § 39-23.4 (West 2015); 11 U.S.C. § 548 (2012). For a list of cases where "badges of fraud" have been used as an evaluative measure, see 3B BANKRUPTCY SERVICE, LAWYER'S EDITION § 34:176, Westlaw (database updated Jan. 2017).

158. *Kelly v. Armstrong*, 141 F.3d 799, 802 (8th Cir. 1998).

159. Removing the misrepresentation requirement while still using a "badges of fraud approach . . . create[s] unjustified and unnecessary leverage in favor of creditors" because "[e]very constructive fraudulent conveyance will too readily become recast as 'actual fraud.'" Bankruptcy Attorneys' Brief, *supra* note 12, at 5.

160. TEX. BUS. & COM. CODE ANN. § 24.001 (West 1987).

161. TEX. BUS. & COM. CODE ANN. § 24.005 (West 1987). Other states have adopted similar provisions. See generally 3B BANKRUPTCY SERVICE, LAWYERS EDITION, *supra* note 157, at § 34:46 (discussing cases and statutes that use badges of fraud).

162. Van Houter, *supra* note 151, at 1716 (noting that Congress's goals in bankruptcy include "preventing dishonest fraudsters from evading liability by hiding behind the bankruptcy code.").

163. See *infra* Part II.

situations where debtors have malicious intent,¹⁶⁴ using badges of fraud as evidence for actual fraud does exactly the opposite: it captures constructive fraud by looking to objective criteria, rather than intent.¹⁶⁵ Using badges of fraud will encompass situations Congress never intended to be within the scope of Section 523(a)(2)(A).¹⁶⁶ The following examples of cases that will now fall under Section 523(a)(2)(A) are a few that have caused the most concern for bankruptcy experts before, and in the wake of, *Husky*.¹⁶⁷

2. *Examples of Cases That Would Fall Within the Scope of Section 523(a)(2)(A) Post-Husky*

a. *The Insolvent but Generous Family Member*

One situation that could arise if Section 523(a)(2)(A) continues to apply the badges of fraud approach has been discussed on several occasions by Professor G. Eric Brunstad, Jr.¹⁶⁸ His major concern with the Supreme Court's decision in *Husky* is that it will capture innocent debtors whose situations, by chance rather than intent, meet several badges of fraud and, as lower income individuals are more vulnerable to predatory litigation by creditors.¹⁶⁹ His illustration of this problem involves a destitute mother, on the verge of insolvency, whose son needs money for his own rent.¹⁷⁰ She gives him what little cash she might have.¹⁷¹ This mother likely has no knowledge of the laws of bankruptcy or fraudulent transfers, but she may have met up to five badges of fraud.¹⁷² Specifically, she transferred money to an insider (her son); she likely did not alert her creditors, which would permit them to claim the transfer was concealed; she might have given her son the cash, even after a suit was filed against her because she valued helping her son over her creditors and did not understand the gravity of the situation; the transfer may have been most of the cash she had; or she might have been insolvent or became insolvent shortly after giving her son the money.¹⁷³ While this mother might be uninformed, she likely did not intend

164. *Neal v. Clark*, 95 U.S. 704, 709 (1877).

165. Bankruptcy Attorneys' Brief, *supra* note 12, at 5 ("Every constructive fraudulent conveyance will too readily become recast as 'actual fraud' . . .").

166. *See infra* Part II.B.2.

167. *Id.*

168. Professor Brunstad is a partner with Dechert LLP, a bankruptcy professor at NYU School of Law, and a contributor to the Collier treatise on bankruptcy law. G. Eric Brunstad, Jr., DECHERT, LLP, https://www.dechert.com/eric_brunstad/ (last visited May 17, 2017).

169. *Experts Discuss Husky*, *supra* note 148.

170. *Id.*

171. *Id.*

172. *See supra* text accompanying note 161 (listing the badges of fraud used by the State of Texas).

173. *Experts Discuss Husky*, *supra* note 148.

to deceive her creditors.¹⁷⁴ Rather, she felt she needed to meet her obligations of motherhood.¹⁷⁵ This is a classic situation where a regular person needs bankruptcy to achieve a fresh start and likely not the type of situation that Congress intended to be excepted from discharge.¹⁷⁶

b. Aggressive Creditor

Other bankruptcy experts are concerned about the “unjustified and unnecessary leverage in favor of creditors” that the Court’s holding in *Husky* creates.¹⁷⁷ They argue that including fraudulent transfers in Section 523(a)(2)(A) will incentivize creditors to make loans to small business owners on the verge of bankruptcy.¹⁷⁸ Then, almost any move the entrepreneurs make with the borrowed money in pursuit of reviving or expanding their business could fall within several badges of fraud.¹⁷⁹ If the creditors can establish several badges of fraud and cast the business owner’s actions as constructively fraudulent, then the business owner will likely be unable to overcome that presumption because of the cost of litigation.¹⁸⁰ If the business owners cannot rebut the presumption the creditors have created, the creditors have produced a win-win situation for themselves. If the debtor can repay its debts, the creditors earn their fees. If the debtor cannot pay its debts, the creditors can skim off the top of the bankruptcy estate by filing under Section 523(a)(2)(A). When passing the Federal Bankruptcy Reform Act, Congress did not intend to hinder small businesses, but rather to encourage them by relieving them of debt when necessary.¹⁸¹ Congress could not have wanted creditors to have adversary claims against every move a business makes, which is why it put “actual,” and not “constructive,” fraud into the statute.¹⁸² This incongruity, again, demonstrates the insufficiency of the badges of fraud approach.

174. *Id.*

175. *Id.*

176. Van Houter, *supra* note 151.

177. Bankruptcy Attorneys’ Brief, *supra* note 12, at 5.

178. *Id.*

179. *Id.* at 7. Badges of fraud that would likely be implicated in this situation include: transferred substantially all assets; removed or concealed assets; and became insolvent shortly after transfer was made. *Id.*

180. *Id.* at 5 (“Every constructive fraudulent conveyance will too readily become recast as ‘actual fraud.’”).

181. APARNA MATHUR, BEYOND BANKRUPTCY: DOES THE BANKRUPTCY CODE PROVIDE A FRESH START TO ENTREPRENEURS? 2 (2011) (“[T]he bankruptcy procedure provides failed entrepreneurs the ability to get back on their feet by reducing or eliminating their pre-bankruptcy debts.”).

182. 124 CONG. REC. 33,998 (1978) (noting that Section 523(a)(2)(A) was intended to include actual or positive fraud, not constructive or implied fraud).

c. Multiple Creditors

The Court's holding in *Husky* creates another quandary, unrelated to the application of badges of fraud, but still problematic because of the use of that standard. Former Judge Eugene R. Wedoff posed the issue in a debate analyzing *Husky* before the Court issued its opinion.¹⁸³ What happens if five creditors each give Company A \$100 and Company A fraudulently transfers \$250 of that \$500 to Company B?¹⁸⁴ If "actual fraud" was limited to misrepresentation, this kind of issue would not arise because the misrepresentation that caused the assets to be unavailable would be directed at a specific creditor.¹⁸⁵ Because including fraudulent transfers in Section 523(a)(2)(A) opens the possibility for multiple creditors to initiate adverse proceedings on the same transfer, there needs to be a solution to this type of situation.¹⁸⁶ Professor Anthony Casey suggests that all of these creditors should receive their pro rata share.¹⁸⁷ The more creditors added to the scenario, however, the more complicated the situation becomes.¹⁸⁸ If one hundred creditors make a claim to the transferred money, do they all have the same right to those assets?¹⁸⁹ Will Section 523(a)(2)(A) need to accommodate class action suits?¹⁹⁰ If one creditor can show she was harmed more directly than another (for example, that she lent money more closely to the time of filing for bankruptcy), is she entitled to a greater portion of those assets?¹⁹¹ Though this issue is more procedural and less substantially related to the badges of fraud, a new approach could solve this problem, too.¹⁹²

C. A New Standard of Fraud—PSLRA's "Strong Inference" Pleading Standard

The current standard for evaluating fraud in a fraudulent transfer, which is now within the scope of Section 523(a)(2)(A), is insufficient.¹⁹³

183. *Experts Discuss Husky*, *supra* note 183.

184. *Id.*

185. Removing the connection between the incurrence of the debt and the fraud makes Section 523(a)(2)(A) a "general dischargeability provision." *Id.*

186. *Id.*

187. *Id.* Professor Anthony Casey is now a bankruptcy professor at the University of Chicago School of Law, after having been a bankruptcy partner at Kirkland & Ellis, LLP. *Anthony J. Casey*, UNIV. OF CHICAGO LAW SCHOOL, <http://www.law.uchicago.edu/faculty/casey> (last visited May 17, 2017).

188. *Experts Discuss Husky*, *supra* note 183.

189. *Id.*

190. *Id.*

191. *Id.*

192. *See infra* Part II.

193. *See supra* Part II.B.2.

Badges of fraud are too broad and do not fulfill the intent of the Bankruptcy Reform Act to capture only actual, and not constructive, fraud.¹⁹⁴ Courts and legislatures could best meet Congress's intentions by implementing a new standard of fraud for fraudulent conveyances, as is necessary in light of the Court's holding in *Husky*. This new standard must meet several criteria. It must protect the honest but unfortunate debtor, like the indigent mother in Professor Brunstad's hypothetical.¹⁹⁵ It must prevent aggressive creditors from manipulating small business owners into exception of discharge as a result of constructive fraud.¹⁹⁶ It must also protect similarly situated creditors to settle some of the difficulties involved in Judge Wedoff's scenario in which a class of creditors stake claim to the same set of assets.¹⁹⁷ The new standard must give preference to the creditors actually harmed, not to parasitic creditors trying to jump their place in line.

The new requirement must also effectuate Congress's intention for "actual fraud" by only including acts committed with malicious intent and excluding acts that are merely constructively fraudulent.¹⁹⁸ The badges of fraud approach, by using circumstantial evidence that might not be an indication of "moral turpitude,"¹⁹⁹ fails to accomplish Congress's purpose of adding "or actual fraud" into Section 523(a)(2)(A) and implicates many more parties than envisioned.²⁰⁰

There is also a need for Congress to more clearly define its purpose for adding "actual fraud" to Section 523(a)(2)(A). Other areas of the bankruptcy code, such as Section 548 involving fraudulent transfers, might soon be affected by the Uniform Voidable Transactions Act ("UVTA"), the predecessor to the Uniform Fraudulent Transfer Act.²⁰¹ The UVTA, as of 2014, completely removes a requirement of fraud to qualify for relief.²⁰² As states begin to adopt the UVTA, which does not require any showing of actual fraud, and courts interpret the reach of exceptions to discharge involving actual fraud following *Husky*, there will likely be considerable

194. See *supra* note 31.

195. See *supra* Part II.B.2.a.

196. See *supra* Part II.B.2.b.

197. See *supra* Part II.B.2.c.

198. 124 CONG. REC. 33,998 (1978) (explaining that Congress's intent for including Section 523(a)(2)(A) was to capture actual fraud with harmful intent, not constructive fraud).

199. *Neal*, 95 U.S. at 709.

200. See *supra* Part II.B.2.

201. See, e.g., 2016 MICH. PUB. ACTS 552. See generally *Goodbye UFTA, Hello UVTA*, PRACTICAL LAW FINANCE (July 24, 2014), WL Practical Law Article 7-575-2685 (discussing the amendments the Uniform Law Commission has made to the UFTA).

202. Edwin E. Smith, *The 2014 Amendments to the Uniform Voidable Transactions Act (And, Before the Amendments, Known as the Uniform Fraudulent Transfer Act)*, 46 UCC L.J. 245 (2015), 46 No. 3 UCC L. J. ART 5.

confusion in the bankruptcy field that needs to be addressed by a new standard.

The objectives listed above can be satisfied by Congress taking action to create a new pleading standard for actual fraud under Section 523(a)(2)(A) that replicates the PSLRA's "strong inference" standard, discussed below.²⁰³ The PSLRA "strong inference" pleading standard should be adopted as the gatekeeper to litigation, rather than Section 523(a)(2)(A)'s "obtained by" language as Justice Thomas interprets it because the majority in *Husky*, though only in dictum, made clear that fraud is not necessary in the inducement of the extension of debt, a view that, because of this dictum, could quickly and easily become the general view.²⁰⁴ The strong inference standard would result in a holistic review of every situation,²⁰⁵ rather than making conclusions based on facts that might not be relevant to fraudulent intent.²⁰⁶

1. Brief Overview of Securities and Exchange Commission Acts and Rule 10b-5

The Securities Act of 1933, also known as the "truth in securities act," was passed to "provide full and fair disclosure of the character of securities sold . . . and to prevent frauds in the sale thereof."²⁰⁷ Congress then passed the Securities Exchange Act of 1934 ("1934 Act"), "to provide for the regulation of securities exchanges and . . . to prevent inequitable and unfair practices on such exchanges and markets."²⁰⁸ The 1934 Act also allows private litigants to bring securities claims.²⁰⁹ Private litigants typically bring securities fraud claims under Rule 10b-5, promulgated under Section 10b of the 1934 Act.²¹⁰ Section 10(b) and Rule 10b-5 make employing "manipulative and deceptive devices," making untrue statements or omissions, or engaging in fraudulent or deceitful actions "in connection with the purchase or sale of any security" unlawful.²¹¹

203. *See infra* Part II.

204. *Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1590–94 (2016) (Thomas, J., dissenting). The majority dispelled Justice Thomas's interpretation because "[n]othing in the text of [Section] 523(a)(2) supports that additional requirement." *Id.* at 1589 (majority opinion).

205. *See infra* Part II.C.3.

206. *Id.*

207. *See* Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74.

208. *See* Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881.

209. 15 U.S.C. § 78u-4 (2012).

210. *See* 17 C.F.R. § 240.10b-5 (2016); 15 U.S.C. § 78u-4 (2012).

211. 17 C.F.R. § 240.10b-5.

The Private Securities Litigation Reform Act was passed in 1995 in “response to perceived abuses of securities fraud litigation.”²¹² When stock prices plummeted, classes of shareholders, led by lawyers, brought frivolous suits that corporations would settle simply to avoid costly litigation.²¹³ While Congress knew it needed to find a way to curb meaningless suits, it also sought to protect shareholders’ ability to recover on meritorious claims.²¹⁴ What follows is a discussion on how Congress struck that balance in the PSLRA, how the Court further clarified this legislation, and how the PSLRA’s objectives were similar to the solutions needed for Section 523(a)(2)(A) after *Husky*.²¹⁵ This Comment contends that the PSLRA standard of pleading fraud is the right answer for how courts and legislatures should interpret fraudulent transfers in the bankruptcy context.²¹⁶

2. *The PSLRA Requirements and Tellabs, Inc. v. Makor Issues & Rights, Ltd.*

The PSLRA states that “plaintiffs must ‘state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,’” rather than only satisfying the requirement of Rule 9(b) of the Federal Rules of Civil Procedure.²¹⁷ Congress intended for the term “strong inference” to be a more stringent requirement than “generally” pleading scienter.²¹⁸ It did not, however, define what it meant by “strong inference.”²¹⁹ This led courts in different circuits to develop their own standards of strong inference until the Supreme Court granted certiorari in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*²²⁰

212. Sharon Nelles & Hilary Huber, *Pleading Securities Fraud Claims: The Good, the Bad, and the Ugly*, 45 LOY. U. CHI. L.J. 653, 653 (2014) (quoting *Swack v. Credit Suisse First Boston*, 230 F.R.D. 250, 258 (D. Mass. 2005)); see also Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) (enumerating requirements for private individuals to bring securities law suits to reduce abusive litigation).

213. Nelles & Huber, *supra* note 212, at 653–54.

214. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

215. See *infra* Parts II.C.2 and II.C.3.

216. See *infra* Part II.C.4.

217. *Tellabs, Inc.*, 551 U.S. at 314 (quoting 15 U.S.C. §78u-4(b)(2)). Rule 9(b) requires, “[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.” FED. R. CIV. P. 9(b).

218. Scienter is “the defendant’s intention ‘to deceive, manipulate, or defraud.’” *Tellabs, Inc.*, 551 U.S. at 313 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12, 194 (1976)).

219. *Id.* at 314.

220. For example, before *Tellabs*, the Sixth Circuit evaluated whether there was a “strong inference” of fraud by assessing competing inferences to determine which was the most plausible, while the Seventh Circuit examined all allegations and then decided “whether collectively they establish such an inference.” *Id.* at 317.

In *Tellabs*, the plaintiff alleged that Tellabs, and derivatively, its CEO and President, Richard Notebaert, violated Section 10(b) of the 1934 Act and SEC Rule 10b-5.²²¹ The plaintiff alleged that Tellabs lied to the investing public about the value of Tellabs' stock, the success of the company's operations, and its financials through misrepresentations.²²² Justice Ginsburg, writing for the majority, held that "strong inference" under the PSLRA required a "cogent" inference of scienter that is "at least as compelling as any opposing inference one could draw from the facts alleged."²²³ Additionally, the allegations must not be taken in isolation, but looked at together to determine "whether *all* of the facts alleged, taken collectively, give rise to strong inference of scienter."²²⁴ The Supreme Court vacated the judgment of the court of appeals and remanded the case for evaluation under the newly articulated pleading standard.²²⁵

3. Common Objectives of PSLRA and Section 523(a)(2)(A)

Congress faced similar issues when creating a new pleading standard for the PSLRA as they now face after *Husky*'s broad interpretation of Section 523(a)(2)(A). Both statutes arise out of a need to protect the rights of plaintiffs who feel that they have been taken advantage of through fraud. But both also address the need to balance those rights against the rights of vulnerable defendants who may be subject to attack under these laws when they have been operating legally.²²⁶ The PSLRA recognizes that the federal securities laws are open to abuses by those trying to take advantage of the system.²²⁷ For example, before the PSLRA was enacted, private litigants frequently initiated "strike suits,"²²⁸ which sought to take advantage of large corporations who would find it quicker and easier to settle with a client for the "nuisance value" of the case rather than be threatened with potential

221. *Id.* at 315–17.

222. *Id.* at 313–14.

223. *Id.* at 324.

224. *Id.* at 323.

225. *Id.* at 329.

226. EDWARD LABATON & NICOLE M. ZEISS, INTERPRETING THE PSLRA'S PLEADING REQUIREMENTS AND LEAD PLAINTIFF PROVISIONS (AM. LAW INST. 2002), Westlaw ("The enactment of the PSLRA flowed from the perception, or misperception, that securities class actions had become primarily controlled by plaintiffs' attorneys without, at times, sufficient regard for actionable culpability of the defendants."); *see supra* note 1.

227. Congress passed the PSLRA to "prevent the abuse of federal securities laws by private plaintiffs." *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 406 (5th Cir. 2001).

228. A strike suit is a "suit (esp. a derivative action), often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement." *Suit*, BLACK'S LAW DICTIONARY (10th ed. 2014).

litigation.²²⁹ By elevating the required standard of pleading, Congress removed the incentive to bring strike suits because plaintiffs would have to actually demonstrate there was a “strong inference” of scienter, rather than freely bring claims simply because a corporation’s stock price decreased.²³⁰

A similar need exists in limiting the scope of potential claims under Section 523(a)(2)(A) now that the Court, in *Husky*, found there is no misrepresentation limitation for actual fraud.²³¹ The PSLRA and the Court in *Tellabs* attempted to strike a balance between the rights of plaintiffs who were truly harmed by fraudulent securities offerors and corporations acting legally, but subjected to the ebbs and flows of the market and imperfect business decisions. The courts and legislatures now need to find a balance between the rights of those who extended credit in good faith and expected to be repaid with the rights of vulnerable debtors who actually need the protection of bankruptcy to get a fresh start.²³² Because the standards of fraud approach to evaluating the existence of actual fraud is too broad, like the fraud pleading requirements in private securities litigation before the PSLRA, adopting a standard akin to the PSLRA’s could better protect the rights of creditors and debtors.

By adopting the Court’s interpretation of “strong inference” of fraudulent intent in *Tellabs* as the standard for assessing whether a transfer falls within the scope of “actual fraud,” the burden on defendants whose actions appear to constitute “actual fraud” under the badges of fraud test, but who actually act with honest intentions will be relieved. Judges and juries would have the power, instead of merely identifying whether certain outward indicia exist, to actually evaluate the situation as a whole and determine whether the defendant’s conduct was that of fraud or simply that of someone with an immense financial burden with no other way to turn.

4. *The Benefits of Adopting Tellabs’ Pleading Standard for Section 523(a)(2)(A) Outweigh Concerns of Its Efficacy in the Securities Context*

Though there are valid concerns with *Tellabs*’s “strong inference” test, they will not be as problematic when applied to Section 523(a)(2)(A) for

229. Nuisance value abuses involve “nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests and manipulation by class action lawyers.” *Tellabs, Inc.*, 551 U.S. at 320 (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)).

230. *Id.* at 313 (“Exacting pleading requirements are among the control measures Congress included in the PSLRA.”).

231. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1590 (2016) (“[W]e interpret ‘actual fraud’ to encompass fraudulent conveyance schemes, even when those schemes do not involve a false representation.”).

232. *See Understanding Bankruptcy*, *supra* note 1.

several reasons.²³³ First, while the expansion of “actual fraud” under Section 523(a)(2)(A) may lead to more litigation, it is a relatively narrow issue.²³⁴ And, although the PSLRA was created as a global solution to improve and restrain all private securities litigation, the “actual fraud” element of Section 523(a)(2)(A) will only apply where a fraudulent transfer did not occur within one year of the defendant filing for bankruptcy,²³⁵ and where there was no misrepresentation.²³⁶ If either of these circumstances are present, there will be a bright line test to determine liability which will not require the same depth of consideration.

Additionally, using the “strong inference” pleading standard as a gatekeeping function would clarify confusion that could stem from the adoption of the UVTA and its omission of a fraud requirement.²³⁷ At least one court, for example, has issued an opinion that obscured the distinction between states that require fraud and those that do not.²³⁸ The confusion regarding the diminishing role of fraud in the UVTA, compounded by *Husky* heightening the importance of actual fraud, further demonstrates the necessity that Congress affirmatively enact a new pleading standard to eliminate any doubt about its objectives regarding the addition of “actual fraud” to Section 523(a)(2)(A). Just as Congress enacted a pleading standard for the PSLRA separate from other securities laws, it could do the same for this narrow element of Section 523(a)(2)(A).²³⁹

5. Benefits of Using the Strong Inference Standard

Using the strong inference test from the PSLRA instead of the badges of fraud test can, first, cure some of the reservations experts have had about

233. See *infra* notes 234–239 and accompanying text. See generally Arunesh Sohi, *Circuits in Disarray Before and After Tellabs v. Makor: A Call For the Supreme Court to Weigh in on Securities Fraud Pleading Requirements Again*, 38 SEC. REG. L.J. 3 (2010) (discussing the changes circuits have made since *Tellabs* and how, even after making changes, the circuits are still not in agreement on how to treat the “strong inference” standard).

234. Diane Davis, *High Court’s Husky Is ‘Narrow,’ Leaves Unanswered Questions*, 28 BLOOMBERG BANKR. L. REP. 671, 671 (2016) (observing that while *Husky* might “create more problems than it solves,” the facts involved in cases implicating *Husky*’s decision are unique).

235. There is no need for an “actual fraud” inquiry if the transfer occurred within one year of the creditor filing its petition. 11 U.S.C. § 727(a)(2)(A) (2012).

236. There is no need for an “actual fraud” inquiry if there has been an express misrepresentation because that is already listed as its own cause of action under the statute. See *id.* § 523(a)(2)(A).

237. See *supra* note 201 and accompanying text.

238. See, e.g., *In re Tribune Co. Fraudulent Conveyance Litig.*, No. 12-CV-2652, 2017 WL 82391 (S.D.N.Y. Jan. 6, 2017).

239. According to Bankruptcy Rule 7009, Rule 9 of the Federal Rules of Civil Procedure applies to adversary proceedings. FED. R. BANKR. P. 7009; see also *supra* note 217 (discussing Federal Rules of Civil Procedure Rule 9(b) and Congress’s separate pleading standard for the PSLRA).

the Court's holding in *Husky* and, second, address the growing divergence in the meaning and use of actual fraud in bankruptcy. In Professor Brunstad's scenario, the crux of the problem was that the nearly insolvent mother who lent her son money for rent had no fraudulent intent and likely did not know that what she was doing could possibly subject her to an exception from discharge.²⁴⁰ Under the badges of fraud test, though, the satisfaction of badges of fraud would require her to bear the heavy burden of overcoming a rebuttable presumption of fraud. If a court uses the strong inference test, she would only have to prove that a reasonable person would find her acting with fraudulent intent less likely than her acting with an innocent frame of mind, arguably a lighter load to bear. In the National Association of Consumer Bankruptcy Attorney's amicus brief in support of Ritz, experts worried that creditors would use their superior bargaining power to manipulate debtors, especially small and new business owners, into situations where they could make transfers that would constitute several badges of fraud while taking risks to revive their businesses.²⁴¹ Similar to Professor Brunstad's example above, the small business owners would have an easier job of proving their innocent frame of mind under a strong inference test than with badges of fraud. Additionally, if creditors know that the debtors would have an easier time of proving their innocent frame of mind in court, they might not extend predatory loans to those businesses because their chances of having priority in the debtor's bankruptcy estate will be significantly decreased.

Judge Wedoff's concern over how courts will apply Section 523(a)(2)(A) when multiple creditors claim they were affected by the same fraudulent transfer is likely the trickiest of the issues posed. This too, however, can be at least partially remedied by using the PSLRA's strong inference test. By giving the judge or jury more power to look into the totality of the circumstances, rather than just tallying how many badges of fraud are involved in a situation, they can look more deeply into how a debtor's scienter, or lack thereof, relates to any of the creditors filing adverse proceedings individually. A judge or jury could consider the circumstances and try to understand the state of mind of the debtor, which would allow it to determine whether the fraudulent transfer was intentionally done to defraud or disadvantage a specific creditor more so than others.

The benefits of the strong inference standard would also apply to the *Husky* case. Rather than looking to which badges of fraud Ritz met, the

240. See *supra* Part II.B.2.A.

241. Bankruptcy Attorneys' Brief, *supra* note 12, at 7.

Court could look broadly at all of his business endeavors,²⁴² his lack of trustworthiness,²⁴³ and the circumstances of his relationship with Husky.²⁴⁴ It would then be much easier for a judge or jury to find that Ritz did act with scienter and that his debt to Husky should not be discharged.

III. CONCLUSION

The Supreme Court in *Husky* came to the correct conclusion in holding that “actual fraud” does not require a misrepresentation by the debtor to the creditor.²⁴⁵ This decision, however, will likely do little to stem the tide of litigation arising out of Section 523(a)(2)(A).²⁴⁶ As long as courts and legislatures continue to use the “badges of fraud” approach in determining whether a debtor has engaged in “actual fraud,” creditors will continue to hale innocent but vulnerable debtors into court or force settlements outside of court where predatory creditors take advantage of the vulnerability of the debtors who truly do need the protection that bankruptcy provides.²⁴⁷

If Congress adopted the “strong inference” pleading standard used in private securities litigation, courts would have to do a more searching inquiry into the actual motives and intentions of debtors. The new standard would avoid excepting from discharge the debts of a variety of groups of innocent debtors, like the ones discussed above.²⁴⁸ Congress, in making this change, would preserve the meaning of “actual fraud” and clarify its intentions in adding the “actual fraud” language to Section 523(a)(2)(A), while reducing the volume of related litigation and the potential for innocent debtors to be unfairly strong-armed by their creditors.

242. *Husky Int’l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1585 (2016) (noting all of the businesses Ritz held ownership in, his percentage of ownership, and the amount of money he transferred to them from Chrysalis).

243. *In re Ritz*, 459 B.R. 623, 629, 636 (Bankr. S.D. Tex. 2011), *aff’d*, 513 B.R. 510 (S.D. Tex. 2014), *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), *vacated and remanded sub nom. In re Ritz*, No. 14-20526, 2016 WL 4253552 (5th Cir. Aug. 10, 2016) (“The Court finds Ritz is not a credible witness . . . this Court shares Husky’s view that the Debtor is not an upstanding businessman who can be trusted.”).

244. *Husky Int’l Elecs., Inc.*, 136 S. Ct. at 1585 (noting that Ritz could have used the transferred money to pay Husky what it was owed).

245. *See supra* Part II.A.

246. *See supra* Part II.B.

247. *See supra* Part II.B.

248. *See supra* Part II.B.