'Til Fraud Do Us Part

Bartenwerfer v. Buckley

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The passive voice may be the bane of English teachers and writers everywhere, but from time to time, we all let it creep into our writing. As it turns out, Congress is no exception here. The drafters of the Bankruptcy Code used the passive voice when listing exceptions to the bankruptcy discharge. Interpretation of that language – and the role of the passive voice – was the subject of a recent Supreme Court decision.

In *Bartenwerfer v. Buckley*,[1] the Supreme Court held that the Bankruptcy Code's prohibition on discharging debt for money "obtained by … fraud" extends to a situation where a debtor is held liable for fraud that she did not personally commit.[2]

At first blush, the Court's decision appears straightforward, even unremarkable. It is yet another example of the Court's adherence to textualism. It is also, somewhat sadly, yet another example of murky drafting in the Bankruptcy Code. But, upon further reflection, *Bartenwerfer* is more than just a showcase for trends and facts we are already aware of.

Notably, the facts in *Bartenwerfer* involved a wife trying to distance herself from fraud perpetrated by her husband. The Court based its decision

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[1] 143 S. Ct. 665 (2023).

[2] *Id.* at 670.

denying the wife's bankruptcy discharge on the fact that the Bartenwerfers were more than mere spouses: they were also business partners. Given these facts, the extent to which *Bartenwerfer* may apply to other situations involving spouses is unclear. Put differently, *Bartenwerfer* raises the question of when a spouse is more than a spouse for purposes of imputing fraud liability.

I.
COUPLES FRAUD

Bartenwerfer arose from a home sale gone wrong. Kate and her then-boyfriend (later husband) David Bartenwerfer bought a house together with the goal of remodeling it and reselling it at a profit. David was primarily responsible for the remodel, and Kate was mostly uninvolved. The Bartenwerfers sold the remodeled house to Kieran Buckley. After the purchase, Buckley discovered defects in the house that David and Kate had failed to disclose. Buckley sued the Bartenwerfers, claiming that he overpaid for the house in reliance on their fraudulent misrepresentations. A California jury found for Buckley and held both Bartenwerfers responsible for over $200,000 in damages. Shortly thereafter, the Bartenwerfers filed for chapter 7 bankruptcy.[3]

In the bankruptcy proceedings, Buckley maintained that the damages from the state fraud trial were a nondischargeable debt, meaning that the Bartenwerfers would still be liable for the full amount notwithstanding their bankruptcy case. To support his argument, Buckley relied on § 523(a)(2)(A) of the Bankruptcy Code, which bars the discharge of "an individual debtor from any debt … for money … to the extent obtained by … false pretenses, a false representation, or actual fraud."[4] Thus, Buckley's argument was that the $200,000-plus debt was for money obtained by the Bartenwerfers' fraudulent conduct and, therefore, it couldn't be discharged in a bankruptcy case.

The bankruptcy court agreed with Buckley and held that the debt was non-dischargeable as to both Bartenwerfers.[5] It first found that David Bar-

[3] *Id*.

[4] 11 U.S.C. § 523(a)(2)(A) (2023).

[5] *Bartenwerfer*, 143 S. Ct. at 671.

tenwerfer had acted fraudulently by knowingly concealing the house's defects from Buckley. It then determined that, although Kate was largely uninvolved in the remodel and sale, David's fraudulent intent could be imputed to her, because the two had formed a legal partnership for the purpose of renovating and reselling the house.[6]

On appeal, the Bankruptcy Appellate Panel for the Ninth Circuit ("BAP") held that § 523(a)(2)(A) might not apply to Kate. The relevant inquiry, according to the BAP, was whether Kate knew or had reason to know of David's fraud. If she did, the debt was non-dischargeable. Because the bankruptcy court had not determined Kate's degree of knowledge, the BAP remanded the case to the bankruptcy court to figure this out.[7]

After a second bench trial, the bankruptcy court found that Kate lacked the requisite knowledge of David's fraud. Applying the BAP's reasoning, the bankruptcy court concluded that Kate's liability to Buckley was dischargeable.[8] The BAP affirmed this judgment, and Buckley appealed to the Ninth Circuit.

The Ninth Circuit reversed.[9] Relying on Supreme Court precedent that articulated "basic partnership principles," it held that a debtor who is liable for her partner's fraud cannot discharge that debt in bankruptcy, regardless of her personal culpability.[10] Kate then filed a petition for a writ of certiorari in the Supreme Court.

II.
THE PERILS OF THE PASSIVE VOICE

Justice Amy Coney Barrett's opinion for a unanimous Court closely examined the text and context of § 523(a)(2)(A) to conclude that Kate's debt to Buckley was not dischargeable. Looking to the plain text of § 523(a)(2)(A), the Court concluded that Kate could not discharge the liability to Buckley because: (1) she is an "individual debtor" (i.e., a human being); (2) the

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[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] *Id*.

[10] *In re Bartenwerfer*, 860 Fed. Appx. 544, 546 (9th Cir. Aug. 12, 2021), citing *Strang v. Bradner*, 114 U.S. 555, 561 (1885).

judgment is a "debt"; and (3) that debt arose from the sale proceeds (the "money") obtained by David's fraudulent misrepresentations.[11]

Justice Barrett started by acknowledging the central problem with § 523(a)(2)(A): that portion of the statute is written in the passive voice, meaning that it's unclear *whose* "false pretenses," "false representation," "or actual fraud" must be responsible for obtaining the debt. Kate's argument, as Justice Barrett summarized it, was that the passive voice "hides the relevant actor in plain sight," essentially saying that, although Congress never explicitly said so, the most sensible reading of § 523(a)(2)(A) was that the fraud at issue was fraud committed by the debtor. Since Kate, the debtor, herself had not committed fraud, this reading of the statute would clear the way for her debt to be discharged.[12]

Unfortunately for Kate, the Court disagreed. Instead, it held that the passive voice "pulls the actor off the stage."[13] In other words, Congress did not have a specific actor in mind when it wrote the statute. Consequently, a debtor's debt obtained for money by fraud – *anyone*'s fraud – is non-dischargeable.

Kate argued that the Court should look at context. Other parts of § 523 specify that, in other discharge exceptions, the debtor is the relevant actor to consider. While the Court acknowledged that context *can* confine a passive-voice sentence to a likely set of actors, it noted that in this instance, that wasn't the case: "context does not single out the wrongdoer as the relevant actor." Why not? Because under the common law of fraud, liability for fraud is not limited to the wrongdoer. Instead, principals can be liable for their agents' fraud, and partners can be liable for fraud committed by other partners within the scope of the partnership.[14] Since the common law of fraud doesn't limit the scope of actors liable for the fraud, the Court reasoned, neither does § 523(a)(2)(A). Thus, reading the plain text of the statute in light of context (i.e., the common law of fraud), the statute's wording was broad enough to encompass Kate's debt to Buckley.

The Court bolstered its reasoning by examining § 523(a)(2) as a whole. It noted that subparagraph (A), which was at issue in the case, was worded

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[11] *Bartenwerfer*, 143 S. Ct. at 671.

[12] *Id*. at 672.

[13] *Id*.

[14] *Id*.

differently from subparagraphs (B) and (C).[15] In the latter two subsections, the discharge exception at issue expressly requires *the debtor* to engage in some act, whereas in the former subsection there is no specified actor. Abiding by the maxim that when Congress includes particular language in one section of a statute but omits it in another, courts should take that choice as deliberate, the Court concluded that Congress deliberately intended that the culpability in subparagraph (A) should not be limited to that of the debtor.[16]

Why, exactly, might Congress have made subparagraph (A) different from its neighbors? Although the Court did not have to answer this question, it ventured a guess – at least as to the reason behind the differences in subparagraphs (A) and (B). The Court reasoned that subparagraph (B), which deals with materially false written statements respecting the debtor's financial condition, might have included the requirement that the debtor make or publish the statement with intent to deceive because consumer finance companies sometimes "encourage" (some might say "trick") debtors to make false statements in order to insulate their claims from discharge. Thus, the Court saw the inclusion of the relevant actor (the debtor) in subparagraph (B) as an attempt by Congress to "moderate the burden on individuals who submit[] false financial statements."[17]

The Court also looked to history to aid its analysis. It observed that in a pre-Code case, *Strang v. Bradner*, the Court had held that the fraud of one partner is the fraud of all partners.[18] Congress overhauled the Bankruptcy Code after *Strang* and, according to the Court, appeared to embrace *Strang*'s holding because it deleted the phrase "of the bankrupt" from the predecessor to § 523(a)(2)(A).[19] This further reinforced the Court's belief that Congress's choice to use the passive voice was deliberate in order to remove any requirement of debtor culpability for the kind of conduct described in that subsection.

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[15] *Id*. at 673.

[16] *Id*. ("The more likely inference is that (A) excludes debtor culpability from consideration given that (B) and (C) expressly hinge on it.").

[17] *Id*. at 674, citing Field v. Mans, 516 U.S. 59, 76-77 (1995).

[18] *Id*.

[19] *Id*. at 675.

Kate had also argued that denying her a discharge in this instance would destroy the opportunity for a "fresh start" for herself and debtors like her, innocent partners to those who have actually engaged in fraudulent conduct.[20] The Court's response here was simple: bankruptcy is about balance between debtors and creditors, not simply about handing debtors a fresh start. Indeed, the Court pointed out that if a "fresh start" was the only goal, there would be no discharge exceptions at all.[21]

Having determined that § 523(a)(2)(A) operated to bar discharge of Kate's debt to Buckley, the Court issued some words of caution. First, it noted that neither bankruptcy law nor the Court's decision defines the scope of liability; instead, state law makes that determination.[22] In other words, Kate only found herself in this situation because California state law imputes fraud to honest partners of dishonest actors. Second, it noted that, even if someone (like Kate) is found liable for fraud, there are defenses to liability that someone in Kate's position may be able to assert.[23]

It's reasonably clear that the justices understood that their decision posed a hardship for Kate, an innocent party who happened to have partnered with a fraudster. Nevertheless, the Court reiterated that, under the common law of fraud, innocent people are sometimes caught up in the web of fraud that they did not personally commit.[24] If they happen to declare bankruptcy, they can't get a discharge for debt incurred by that fraud.

Justice Sonia Sotomayor, joined by Justice Ketanji Brown Jackson, wrote a brief concurrence. Justice Sotomayor first acknowledged that the Court was right about § 523(a)(2)(A).[25] She wrote separately, however, to point out that under the stipulated facts, Kate and David Bartenwerfer had an agency relationship.[26] Put differently, they only obtained the debt at issue after they had formed a partnership. Had the facts been different – for instance, had the fraud at issue been committed by someone without

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[20] *Id*.

[21] *Id*. ("[I]f a fresh start were all that mattered, § 523 would not exist.").

[22] *Id*.

[23] *Id*. at 676.

[24] *Id*.

[25] *Id*. (Sotomayor, J., concurring).

[26] *Id*. at 677 ("Because petitioner does not dispute that she and her husband acted as partners, the debt is not dischargeable under the statute.").

an agency or partner relationship to the debtor – the outcome might have been different as well.

III.
WHEN IS A SPOUSE MORE THAN A SPOUSE?

Reactions to the Court's decision have been all over the map. Some have criticized it for being too pro-creditor – in essence, for striking the "wrong" balance – and for being overly selective in its review of the legislative and judicial history surrounding § 523(a)(2)(A).[27] Others have pointed out that although the Bartenwerfers were married, this case was really about business partner fraud, not married couple fraud.[28] Still others have characterized the decision as unremarkable and just another straightforward reading of the Bankruptcy Code.[29]

All of these reactions may have some truth to them. As mentioned, even the Court seemed to acknowledge the harsh result of its decision on an innocent party like Kate. Despite Justices Sotomayor's attempt to cabin the reach of the Court's decision, it's entirely possible that it could be applied to spouses who are not also business partners. And as Professor David Kuney points out, there's a more nuanced history of fraud than the Court implies, and it's possible to conclude that Kate was only vicariously liable for the fraud at issue and that she should get a discharge because of her mere vicarious liability.[30]

On the other hand, it's possible as well to cabin the Court's decision to fraud between business partners and to say that married couples who are partners in love only would not be subject to the same analysis. The Court isn't crystal clear on this, however.

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[27] *See, e.g.*, David R. Kuney, *Supreme Court's Vicarious Liability Approach to Discharge Needs Congressional Reform*, 42 AM. BANKR. INST. J. 22 (2023).

[28] *See, e.g.*, James Nani, *Supreme Court Tackles Fraud Among Business Partners, Not Spouses*, BLOOMBERG L. (Feb. 23, 2023).

[29] *See, e.g.*, Ronald Mann, *Justices Narrow Bankruptcy Relief From Debts Incurred by Fraud*, SCOTUSBLOG (Feb. 23, 2023), www.scotusblog.com/2023/02/justices-narrow-bankruptcy-relief-from-debts-incurred-by-fraud/ ("This case will make no big waves in bankruptcy jurisprudence or elsewhere.").

[30] Kuney, *supra* note 27.

As usual, when the Court engages in a seemingly "straightforward" interpretation of a statute, questions lurk under the surface. For example, when does a spouse become more than "just" a spouse? And does this even make a difference when it comes to a bankruptcy discharge? We can expect these and other questions to be litigated in the wake of this decision – whether in bankruptcy court, or in state courts developing the common law of fraud.

Finally, and perhaps inadvertently, the Court's decision raises questions about the role and importance of marriage. If a case involves two people who are unmarried but living together, or a couple in a civil union, do those couples have the same liability risk as a married couple, especially if the couple at issue is not otherwise involved in a business partnership? Only time will tell.

Conclusion

The passive voice can be a useful tool, but when it is used in legislation, it often generates confusion. In this case, Congress's use of the passive voice, and the Court's interpretation of the Bankruptcy Code, have opened up new questions even as some pressing ones have been resolved.