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Under § 523(a)(2)(A)**

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Cite as: *Debts Based on Fraudulent Misrepresentations of Material Fact may not be Discharged
Under § 523(a)(2)(A)*, 15 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 29 (2023).

Introduction

In general, title 11 of the United States Code (the “Bankruptcy Code”) provides that an individual may be discharged of his or her debts at the conclusion of his or her bankruptcy case.¹ A discharge relieves a debtor from liability for its unpaid pre-petition debts and acts as an injunction, barring a creditor from collecting such debts from the debtor.² However, under section 523(a)(2)(A) of the Bankruptcy Code, an individual debtor cannot be discharged from any debt for money obtained by “false pretenses, a false representation, or actual fraud.”³

This article explores when debtors cannot be discharged of their debts because such debts were based on fraudulent misrepresentations by the debtor to induce the creditor into loaning him or her money. Part I of this article discusses the Congressional intent in establishing rules preventing defrauders from benefitting from the “fresh start” of bankruptcy. Part II examines the scope of fraudulent misrepresentations, ranging from express fraudulent representations to silence or the concealment of material facts. Part III analyzes the varying degrees of reliance that

¹ See generally 11 U.S.C. § 727 (2018).

² See *id.* § 524(a)(2).

³ *Id.* § 523(a)(2)(A).

the courts have applied to creditors when determining whether the loan was induced by the debtor's falsification of material facts.

Discussion

To establish a nondischargeability claim under section 523(a)(2)(A), a creditor must show:

(1) the debtor made representations; (2) that at the time the debtor knew they were false; (3) the debtor made those representations with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on these representations; and (5) the creditor sustained losses as a proximate result of the debtor's representations.⁴

The elements for a nondischargeability claim are relatively straightforward on their face.⁵

However, courts have grappled with section 523(a)(2)(A) when determining what constitutes a fraudulent misrepresentation of material fact and the threshold standard of reliance that the creditor must meet to succeed on a claim under section 523(a)(2)(A).⁶ In light of various arguments from the Supreme Court of the United States and lower courts, it follows that a debtor cannot discharge debts based on fraudulent misrepresentations of material facts, which the debtor either purposefully falsified or omitted, if the creditor justifiably relied on such facts in loaning to the debtor.⁷

I. The Prevention of Fraud is More Important than the “Fresh Start” of Discharging Debts

The Bankruptcy Code's main purpose is to provide a means through which an insolvent debtor can reconcile debts with their creditors and enjoy a “fresh start,” unencumbered by the

⁴ *In re Swing House Rehearsal and Recording, Inc.*, No. 2:16-bk-24760-RK, 2022 WL 4102825, at *41 (Bankr. C.D. Cal. Sept. 8, 2022) (citing *Gomeshi v. Sabban* (*In re Sabban*), 600 F.3d 1219, 1222 (9th Cir. 1992); *Turtle Rock Meadows Homeowners Ass'n v. Slyman* (*In re Slyman*), 234 F.3d 1081, 1085 (9th Cir. 2000)).

⁵ *See id.*; *see also* *First Nat'l Bank of Omaha v. O'Brien*, 555 B.R. 771, 782 (Bankr. D. Kan. 2016).

⁶ *Compare* *Field v. Mans*, 516 U.S. 59, 70 (1995) (applying the standard of justifiable reliance), *with* *Schweig v. Hunter* (*In re Hunter*), 780 F.2d 1577, 1579 (11th Cir. 1986) (applying the heightened standard of reasonable reliance).

⁷ *See* 11 U.S.C. § 523(a)(2)(A); *In re Wyant*, 236 B.R. 684, 695 (Bankr. D. Minn. 1999); *Field*, 516 U.S. at 69–70.

preexisting debts that once burdened him or her.⁸ The Supreme Court has clarified that this new, unencumbered beginning is only available to the “honest but unfortunate debtor.”⁹ The nature of the Bankruptcy Code is to provide protection for debtors and creditors alike, but the Court was careful not to extend this protection beyond the scope of debts incurred through the course of honest dealing.¹⁰ The Court found it unlikely that Congress would favor a defrauder’s interest in a fresh start over the interests of the creditors who were defrauded.¹¹

Similarly, section 523(a)(2)(A) denies a “fresh start” to dishonest debtors. The grounds for nondischargeability on the basis of fraud overlap to serve the same goal; the elements for proving fraud under section 523(a)(2)(A) guard the creditor from a dishonest debtor and deny a debtor of the “fresh start” where such debtor never intended to repay their obligations to creditors.¹² The United States Court of Appeals for the Seventh Circuit has described the section 523 exclusions to discharge as “vital,” both by protecting creditors who have provided loans to fraudulent debtors and by respecting Congress’s intent when enacting the Bankruptcy Code.¹³ However, in the interest of fairness, some courts have “strictly construed [the fraud exception] against the creditor” to promote the Bankruptcy Code’s policy of providing debtors with a fresh start.¹⁴

II. Fraudulent Misrepresentations Under § 523(a)(2)(A) can Include Silence or Concealment of Material Facts

A debtor may not be discharged of their debts if their silence or concealment of material facts creates a false impression with a creditor, regarding a material fact, even when the debtor

⁸ Grogan v. Garner, 498 U.S. 279, 286 (1991).

⁹ *Id.* at 287.

¹⁰ *Id.*

¹¹ *Id.*

¹² See *In re Fletcher*, 345 B.R. 592, 597 (Bankr. N.D. Ohio 2006).

¹³ Mayer v. Spanel Intern. Ltd., 51 F.3d 670, 674 (7th Cir. 1995) (“Congress concluded that preventing fraud is more important than letting defrauders start over with a clean slate, and we must respect that judgment.”).

¹⁴ *In re Rapp*, 375 B.R. 421, 429 (Bankr. S.D. Ohio 2007).

does not expressly make a fraudulent statement.¹⁵ A debtor is required to disclose all material facts to a creditor, and the “material facts” of a transaction are “those facts touching upon the essence of the transaction.”¹⁶ The Bankruptcy Court for the District of Minnesota has clarified that the false impression created by omitting material facts must be palpable and appreciable at the time the debtor conveyed it to the creditor for the impression to amount to a misrepresentation of material fact.¹⁷

III. A Creditor Must Meet the Standard of Justifiable Reliance Upon the Debtor’s Fraudulent Misrepresentations

To succeed on a section 523(a)(2)(A) claim, courts must find that the creditor relied upon the debtor’s fraudulent misrepresentation of a material fact.¹⁸ Courts have disagreed as to whether the standard should be actual reliance, reasonable reliance, or justifiable reliance.¹⁹ The Supreme Court has determined that section 523(a)(2)(A) requires the creditor to demonstrate that it justifiably relied on the debtor’s inducement.²⁰ However, prior to this decision, many courts required the creditor to prove a heightened standard—that its reliance upon the fraudulent misrepresentation was reasonable.²¹

a. Courts Previously Required the Heightened Standard that the Creditor Reasonably Relied Upon the Debtor’s Fraudulent Misrepresentations Under § 523(a)(2)(A)

¹⁵ *In re Wyant*, 236 B.R. 684, 695 (Bankr. D. Minn. 1999) (“[S]ilence, or the concealment of a material fact, can be the basis of a false impression which creates a misrepresentation actionable under section 523(a)(2)(A).”) (quoting *In re Maier*, 38 B.R. 231, 233 (Bankr. D. Minn. 1984)).

¹⁶ *Caspers v. Van Horne (In re Van Horne)*, 823 F.2d 1285, 1288 (8th Cir. 1987).

¹⁷ *See In re Wyant*, 236 B.R. at 697.

¹⁸ *In re Swing House Rehearsal and Recording, Inc.*, No. 2:16-bk-24760-RK, 2022 WL 4102825, at *41 (Bankr. C.D. Cal. Sept. 8, 2022).

¹⁹ *See, e.g.*, Hon. Nancy C. Dreher & Matthew E. Roy, *Bankruptcy Fraud and Nondischargeability Under Section 523 of the Bankruptcy Code*, 69 N.D. L. REV. 57, 70 (1993) (“Although courts universally hold that actual reliance must be shown, there is a split of authority as to whether the creditor must prove the additional element that its reliance upon the representation was reasonable.”).

²⁰ *Id. See generally* *Field v. Mans*, 516 U.S. 59 (1995).

²¹ *See Dreher, supra* note 19, at 70.

Some of the courts that used the reasonable reliance standard created their own test for a creditor to prove a case under section 523(a)(2)(A).²² For example, the United States Court of Appeals for the Eleventh Circuit held that a creditor must prove that: (1) the debtor, with the intention of deceiving the creditor, made a false representation; (2) the creditor relied on the misrepresentation; (3) the creditor's reliance on the misrepresentation was reasonably founded; and (4) the creditor sustained a loss resulting from the debtor's misrepresentation.²³

In the case of *Commonwealth Land Title Ins. Co. v. Homer (In re Homer)*, a bankruptcy court in Georgia, which is in the Eleventh Circuit, described the creditor's burden in proving reasonable reliance as requiring lenders to review the creditworthiness of their debtors with a reasonable degree of care.²⁴ The bankruptcy court explained that the outer limits of a creditor's duty to determine whether the debtor was an honest one depended upon the facts of each individual case.²⁵ The reasonable person standard did not require a creditor to discover all available public information about the debtor, but rather that he acted with the same degree of due diligence as would a reasonable person.²⁶

b. A Creditor Must "Justifiably Rely" Upon the Debtor's Fraudulent Misrepresentations Under § 523(a)(2)(A)

Some courts, like those mentioned in part III(a) above, adopt the reasonable reliance requirement because section 523(a)(2)(B), the subsection immediately following section 523(a)(2)(A), expressly requires a creditor to prove reasonable reliance.²⁷ However, courts have noted that this clarification as to the reliance standard in section 523(a)(2)(B) does not support

²² See *In re Malcolm*, 145 B.R. 259, 264–65 (Bankr. N.D. Ill. 1992) (utilizing the element of "actual and reasonable reliance" to support a finding in favor of the plaintiff's claim under section 523(a)(2)(A)).

²³ See *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577, 1579 (11th Cir. 1986).

²⁴ 168 B.R. 790, 803 (Bankr. N.D. Ga. 1994) ("Creditors do not have to conduct an exhaustive review of a borrower's representations, merely a commercially reasonable one . . .").

²⁵ *Id.* at 802.

²⁶ *Id.*

²⁷ See 11 U.S.C. § 523(a)(2)(B) (2018).

the conclusion that Congress intended for section 523(a)(2)(A) to also require reasonable reliance.²⁸ Justifiable reliance has a lesser burden than reasonable reliance, as justification does not need to conform to the reasonable person standard. Indeed, a person can be found to have justifiably relied upon a misrepresentation of fact even if the creditor could have ascertained the falsity of the debtor’s representation through an investigation prior to lending.²⁹

After the Supreme Court clarified the reliance standard in the 1995 case of *Field v. Mans*, lower courts subsequently adopted justifiable reliance as the standard for a finding under section 523(a)(2)(A). In *AT&T Universal Card Servs. Corp. v. Feld (In re Feld)*, the Bankruptcy Court for the Eastern District of Pennsylvania further clarified that reliance “is justifiable if the falsity of the representation is not apparent to one of his knowledge and intelligence from a cursory glance.”³⁰ The bankruptcy court in *FTC v. Lake (In re Lake)* explained that justifiable reliance involves both an inquiry into the creditor’s state of mind and an objective assessment of whether the beliefs formed by the creditor are, at the least, valid.³¹

Conclusion

The Supreme Court has interpreted Congress’s intent in writing section 523(a)(2)(A) as prioritizing the prevention of fraud over allowing fraudulent debtors to benefit from the “fresh start” of bankruptcy. Courts have broadly defined “fraudulent misrepresentations of material fact” to include misrepresentations by omission, which are made by debtors who purposefully conceal or falsify material facts to induce lenders. According to the courts, a debtor may not be

²⁸ See *Field v. Mans*, 516 U.S. 59, 66–67, 69–70 (1995) (“[N]either the structure of § 523(a)(2) nor any explicit statement in § 523(a)(2)(A) reveals, let alone dictates, the particular level of reliance required by § 523(a)(2)(A), and there is no reason to doubt Congress’s intent to adopt a common-law understanding of the terms it used.”).

²⁹ *Id.* at 70 (interpreting the Restatement (Second) of Torts (1976) to express that actual and justifiable reliance is required when establishing fraudulent misrepresentations).

³⁰ 203 B.R. 360, 370 (Bankr. E.D. Pa. 1996) (internal quotation marks omitted).

³¹ 628 B.R. 664, 674 (Bankr. C.D. Cal. 2022), *rev’d*, 647 B.R. 213 (2022).

discharged of its debts under section 523(a)(2)(A) if a creditor *justifiably* relied upon fraudulent misrepresentations of material facts when loaning to such a debtor.