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Debtor Needs to have Benefitted from Fraud to be Barred a Discharge Under 11 U.S.C. § 523(a)(2)(A)

Elizabeth Tighe

ST. JOHN'S UNIVERSITY SCHOOL OF LAW

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Elizabeth Tighe, J.D. Candidate 2024

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Introduction

Title 11 of the United States Code (the "Bankruptcy Code") provides that a court may grant a debtor a discharge of its debts, subject to certain conditions and exceptions.[1] One exception to dischargeability is set forth in section 523(a)(2)(A), which bars a discharge from 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, other than a statement respecting the debtor's or an insider's financial condition."[2]

A key phrase in the statute is "obtained by" and courts have applied a few different interpretations to this phrase.[3] Further, the Supreme Court has broadly interpreted the "obtained by" requirement, signaling to lower courts that excepting more debts related to fraud from dischargeability is appropriate.[4] This article examines the three interpretations courts have applied to section 523(a)(2)(A) and which is appropriate, especially considering the most recent Supreme Court decision. Part I focuses on the authority section 523(a)(2)(A) grants courts to

[1] *See* 11 U.S.C. § 727 (2018).
[2] 11 U.S.C. § 523(a)(2)(A).
[3] *See In re* Wade, 43 B.R. 976, 980 (Bankr. D. Colo. 1984).
[4] *See* Cohen v. De La Cruz, 523 U.S. 213, 217 (1998); *see also* Bartenwerfer v. Buckley, 143 S. Ct. 665, 670 (2023).

except certain debts from a discharge and the requirements to fall under this exception. Part II examines two of the Supreme Court interpretations of section 523(a)(2)(A) to demonstrate the extent it is appropriate for lower courts to except certain debts from a discharge under the statute. Part III examines the three interpretations courts have applied to section 523(a)(2)(A) and references how the Supreme Court decisions impact these interpretations.

I. The Bankruptcy Code Requires Courts to Decline to Discharge a Debtor's Debts Obtained by Fraud Through 11 U.S.C. § 523(a)(2)(A).

Section 523(a)(2)(A) provides authority for courts to deny the discharge of debts obtained by "false pretenses, a false representation, or actual fraud."[5] The purpose of this section of the statute is to penalize a debtor's fraud by not allowing them to discharge debts relating to deceptive behavior.[6] Moreover, a court "must narrowly construe exceptions to discharge against the creditor and in favor of the Debtor."[7]

A. Requirements for a Debt to be Nondischargeable under 11 U.S.C. § 523(a)(2)(A).

Courts have established the following five elements for a debt to be nondischargeable under section 523(a)(2)(A): "[t]he debtor made a false representation; the debtor made the representation with the intent to deceive the creditor; the creditor relied on the representation; the creditor's reliance was reasonable; and the debtor's representation caused the creditor to sustain a loss."[8] Moreover, an additional element relates to the "obtained by" language in the statute. Courts disagree as to what extent a debtor must have actually received the result of its fraud for its debt to be nondischargeable.[9]

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[5] 11 U.S.C. § 523(a)(2)(A); *See In re* Hanson, 432 B.R. 758, 776 (Bankr. N.D. Ill. 2010) (finding a debtor, who misappropriated two of three of the creditor's loans, liable for the two loans after filing for bankruptcy); *see also In re* Giquinto, 388 B.R. 152, 158 (Bankr. E.D. Pa. 2008) (allowing a discharge of a creditor's claim after the court failed to find fraudulent inducement).
[6] *See* United States v. Stelweck, 108 B.R. 488, 493 (E.D. Pa. 1989).
[7] *In re* Wade, 43 B.R. at 981 (citing Gleason v. Thaw, 236 U.S. 558, 561 (1915)).
[8] Fowler Bros. v. Young (*In re* Young), 91 F.3d 1367, 1373 (10th Cir. 1996).
[9] 11 U.S.C. § 523(a)(2)(A); *See In re* Wade, 43 B.R. at 980 (explaining the three different approaches courts take to determine whether the debtor did obtain).

II. The Supreme Court Broadly Interpreted 11 U.S.C. § 523(a)(2)(A)'s "Obtained By" Requirement.

In *Cohen v. De La Cruz,* the Supreme Court denied a discharge from an award for treble damages that had been granted to the creditor resulting from the debtor's fraud.[10] According to the Supreme Court, section 523(a)(2)(A) was intended to make the creditor whole from the harm of the fraud and favor them over the perpetrators of fraud.[11] Consequently, lower courts appear to construe the "obtained by" element less restrictively so more debts are nondischargeable.[12]

Earlier this year, the Supreme Court examined section 523(a)(2)(A) in *Bartenwerfer v. Buckley*, where the Court held that a business partner, who did not themselves commit fraud, was nevertheless barred from discharging their debt related to fraud since their debt arose from their partner's fraudulent activity.[13] In this instance, the debtor argued that "obtained by" referred to the individual debtor's fraud, but the court disagreed and emphasized that the statute is broad and applies when the debt is "obtained by" fraud, regardless of who was the perpetrator.[14]

Like in *Cohen*, the Court in *Bartenwerfer* addressed the need to help creditors who are victims of fraud at the expense of giving debtors a fresh start, even in this case where the debtor did not herself engage in fraud.[15] After the broad interpretation of section 523(a)(2)(A) in *Bartenwerfer* and considering the impact of the Court's decision in *Cohen,* lower courts will

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[10] 523 U.S. 213, 215 (1998).
[11] *Id.* at 222 (quoting Grogan v. Garner, 498 U.S. 279, 287 (1991)) ("[I]t is unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud.").
[12] 11 U.S.C. § 523(a)(2)(A); s*ee* Glencove Holdings v. Bloom (*In re* Bloom), No. 22-1005, 2022 U.S. App. LEXIS 19089, at *17 (10th Cir. July 12, 2022) ("With the broad interpretation in *Cohen*, the Supreme Court has suggested § 523(a)(2)(A) does not require that the debtor personally obtain money, property, or services to render the debt nondischargeable."); *Cohen*, 523 U.S. at 218–219 (noting the debtor obtained $31,382.50 of rent payments through fraud as a direct benefit).
[13] 143 S. Ct. 665, 666 (2023) (disregarding who committed the fraud, but focusing on the fact that there was a victim of fraud).
[14] *Id*. at 672.
[15] *Id.* at 675 ("But the Code, like all statutes, balances multiple, often competing interests . . . Barring certain debts from discharge necessarily reflects aims distinct from wiping the bankrupt's slate clean.").

likely continue to apply a broader analysis of the statute when determining how extensive the "obtained by" is.[16]

III. There are Three Ways a Court may Interpret the "Obtained By" Requirement under 11 U.S.C. § 523(a)(2)(A).

Courts have interpreted section 523(a)(2)(A) in three different ways. In particular, the courts have held that the creditor objecting to discharge must show one of the following: (1) the debtor needs to have personally received the money, property, or services for the debt to be nondischargeable; or (2) the debtor just needs to have derived some benefit from the fraud; or (3) the debtor just needs to have obtained the debt through fraud, so there is no requirement of receiving benefits or personally obtaining the money or property for the debt to be discharged.[17]

A. The Debtor Needs to have Personally Received the Money, Property, or Services for the Debt to be Nondischargeable.

A court may interpret "obtained by" in its strictest terms by requiring the debtor to personally receive the money, property, or services that resulted from the fraud.[18] This interpretation would bar dischargeability when "property of some kind, tangible or intangible, was thus obtained by him."[19] In *Rudstrom*, however, the creditor's nondischargeability claim failed because there were no damages, so the court's commentary remains dicta.[20] Moreover, no circuit court has adopted this view that a debtor must personally receive the money to fall under

[16] See *In re* Bloom, 2022 U.S. App. LEXIS 19089, at *15–17 (explaining the impact of Cohen on lower courts); *see also In re* Rassbach, No. 22-11344-7, 2023 Bankr. LEXIS 649, at *18–19 (Bankr. W.D. Wis. Mar. 13, 2023) (noting that after *Bartenwerfer* it is plausible that a wife can be held personally liable for debt from the company she co-owned with her husband despite no personal knowledge of the business dealings with the creditor/plaintiff.).
[17] *See In re* Bloom, 2022 U.S. App. LEXIS 19089, at *12.
[18] *See In re* Wade, 43 B.R. 976, 980 (Bankr. D. Colo. 1984).
[19] Rudstrom v. Sheridan, 142 N.W. 313, 314 (Minn. 1913).
[20] *Id.*; *see also In re* Wade, 43 B.R. at 981 ("Although this language from the Rudstrom case is often cited for the necessity that the Debtor personally receive property, this language is pure dicta.") (emphasis included).

the exception to dischargeability under section 523(a)(2)(A).[21] Instead, circuit courts have adopted one of the two views discussed in the two subsequent sections.[22]

B. The Debtor Only Needs to have Derived Some Benefit from the Fraud.

Some courts have adopted the "receipt of benefits" test, which determines whether the debtor obtained some benefit from the money, property, or services from its fraud, to determine whether the "obtained by" element is satisfied.[23] For example, a debtor who received a loan from a creditor bank for his corporation based on false financial statements was found to have benefited from his fraud, so the bank's claim was nondischargeable despite the loan going to the corporation and not directly to the debtor.[24]

The Eleventh Circuit found the "receipt of benefits" test to be "the more well-reasoned approach."[25] Additionally, the Sixth Circuit has also adopted this view, requiring the plaintiff to show that debtor either directly or indirectly obtained some "benefit as a result of his misrepresentation."[26] Similarly, as observed by the court in *In re Wade*, when no benefit of fraud could be found, a debt may be discharged under the receipt of benefits theory.[27] Further, the court explains that the receipt of benefits test has been longstanding, and that Congress could have chosen to change this test in the present Bankruptcy Code yet chose not to.[28]

Nonetheless, since the Supreme Court's decision in *Cohen*, a number of courts have shifted their view that there does not need to be any personal obtainment or benefit of the fraud

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[21] *See In re* Ritz, 567 B.R. 715, 763 (Bankr. S.D. Tex. 2017).
[22] *See id.*
[23] *See In re* Wade, 43 B.R. at 980.
[24] *In re* Holwerda, 29 B.R. 486, 489 (Bankr. M.D. Fla. 1983) ("If the debtor benefits in some way from the property obtained through his deception, the debt is dischargeable.").
[25] HSSM # 7 Ltd. P'ship v. Bilzerian (*In re* Bilzerian), 100 F.3d 886, 890 (11th Cir. 1996).
[26] *See* Brady v. McAllister (*In re* Brady), 101 F.3d 1165, 1172 (6th Cir. 1996).
[27] *See In re* Wade, 43 B.R. at 982.
[28] *Id.* (concluding that they will not interfere with the interpretation of section 523(a)(2)(A) because Congress granted approval of the test by letting it remain unchanged).

to the debtor.[29] Some courts have specifically called out the circuit courts that have yet to abandon the "receipt of benefits test" as being in conflict with the Supreme Court's decision in *Cohen.*[30]

C. *The Debtor Only Needs to have Obtained the Debt Through Fraud Regardless of Whether they Benefitted from the Fraud***.**

Other courts have concluded that "obtained by" requires that the debtor obtain the debt through fraud, but "[i]t applies plainly to all such obtaining of property by the bankrupt, whether for himself or for anybody else."[31] Some circuit courts have cited to the Supreme Court's decision in *Cohen* as support for this view.[32]

The Supreme Court's 2023 decision in *Bartenwerfer* suggests the Court is once again willing to expand section 523(a)(2)(A)'s ability to bar a discharge of debt arising from fraud.[33] The Court once again placed importance on this section of the Bankruptcy Code in protecting victims of fraud over giving debtor's a clean slate.[34] For instance, in *BancBoston Mortgage Corp. v. Ledford*, the United States Court of Appeals for the Sixth Circuit barred an innocent partner from discharging debts that their partner had received as a result of fraud because the innocent partner benefitted.[35] In light of the *Bartenwerfer* decision, the debtor in *In re Ledford*, would not need to have even benefitted as a result of the partner's fraud, which seemingly

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[29] *See* Glencove Holdings v. Bloom (*In re* Bloom), No. 22-1005, 2022 U.S. App. LEXIS 19089, at *16 (10th Cir. July 12, 2022).
[30] *See In re* Denbleyker, 251 B.R. 891, 896 (Bankr. D. Colo. 2000); *see also In re* Groover, No. 03-51013, 2004 Bankr. LEXIS 2646, at *15 (Bankr. M.D.N.C. Jan. 16, 2004) ("Indeed, even more recently, some courts have called into question this line of cases in light of the Supreme Court's more recent decision in Cohen v. de la Cruz.").
[31] *In re* Kunkle, 40 F.2d 563, 564 (E.D. Mich. 1930).
[32] *See* Muegler v. Bening, 413 F.3d 980, 983 (9th Cir. 2005) (stating that after *Cohen* the receipt of benefits test is no longer a requirement); *see also* Deodati v. M.M. Winkler & Assocs. (*In re* M.M. Winkler & Assocs.), 239 F.3d 746, 749 (5th Cir. 2001) (rejecting the receipt of benefits test to focus on making victims of fraud whole); *see also* Pleasants v. Kendrick (*In re* Pleasants), 219 F.3d 372, 375 (4th Cir. 2000) (explaining the Supreme Court's decision in *Cohen* is broad enough to bar dischargeability even when the debtor obtained no benefit from its fraud).
[33] Bartenwerfer v. Buckley, 143 S. Ct. 665, 670 (2023); *cf.* Muegler, 413 F.3d at 984 (explaining the impact of *Cohen* in interpreting section 523(a)(2)(A)).
[34] *Bartenwerfer*, 143 S. Ct. at 675.
[35] *See* BancBoston Mortg. Corp. v. Ledford (*In re* Ledford), 970 F.2d 1556, 1561 (6th Cir. 1992).

broadens the strength of section 523(a)(2)(A) to protect fraud victims even when their credit is against a debtor.[36]

Conclusion

The receipt of benefits test is still widely used to determine dischargeability of a debt under section 523(a)(2)(A), but the Supreme Court has signaled that any debts related to fraud should not be allowed to be discharged under section 523(a)(2)(A).[37] The decisions supporting the latter view are concerned with protection of fraud victims, and disregard who committed the fraud and who benefitted from the fraud.[38] Courts are no longer limiting a nondischargeability claim to occur when a debtor personally obtains the money, property, or service from fraud; however, it remains unclear whether courts will require a benefit from the fraud or not.[39]

[36] *In re* Ledford, 970 F.2d at 1561; *Bartenwerfer*, 143 S. Ct. at 676 (overruling *In re* Ledford in part because the debtor did not require a receipt of benefit to fall under section 523(a)(2)(A)).
[37] *See Muegler*, 413 F.3d at 984.
[38] *See Bartenwerfer*, 143 S. Ct. at 676; *see also* Cohen v. De La Cruz, 523 U.S. 213, 217 (1998).
[39] *See* Glencove Holdings v. Bloom (*In re* Bloom), No. 22-1005, 2022 U.S. App. LEXIS 19089, at *14 (10th Cir. July 12, 2022) (finding no courts have required a debtor to personally obtain the property to be excepted from discharge).