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Debtors as Predators: The Proper Interpretation of "a statement respecting the debtor's . . . financial condition" in 11 U.S.C. § 523(a)(2)(A) and (B)

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DEBTORS AS PREDATORS: THE PROPER INTERPRETATION OF "A STATEMENT RESPECTING THE DEBTOR'S . . . FINANCIAL CONDITION" IN 11 U.S.C. § 523(A)(2)(A) AND (B)

ABSTRACT

U.S. Courts of Appeals disagree on the correct interpretation of the phrase "statement respecting the debtor's . . . financial condition" as it appears in the exceptions to discharge in 11 U.S.C. § 523(a)(2)(A), the fraud provision, and § 523(a)(2)(B), the false written statement provision. Two major viewpoints have emerged—the strict and the relaxed. Under the strict interpretation, for the fraud provisions to apply, the statement must comprise the overall financial condition of the debtor. According to the relaxed interpretation, the debtor's fraudulent assertion of ownership of only a single item of property constitutes a statement respecting the debtor's financial condition.

The Fifth, Eighth, and Tenth Circuits have adopted the strict interpretation, while the Fourth Circuit has followed the relaxed interpretation since 1984. Lower courts in other circuits have gone both ways. The divergence of opinion has resulted in some courts allowing debtors who acquired money through fraud or misrepresentation to walk away from those debts by discharging them in bankruptcy, while others hold such debtors accountable and refuse discharge.

This Comment interprets § 523(a)(2) and concludes that the correct reading of "financial condition" is the debtor's overall financial health—the view of the courts that have adopted the strict interpretation. This Comment further proposes adding a definition of "financial condition" to 11 U.S.C. § 101 to resolve the circuit split.

This split jeopardizes the dual purposes of bankruptcy—to provide relief to honest debtors and to ensure the fair treatment of creditors. As it is, in some jurisdictions debtors who commit fraud are allowed to abandon their debts, leaving creditors in a lurch. Burning creditors in this way may result in negative repercussions for other debtors, such as decreased borrowing ability. Providing a clear definition of "financial condition" will help promote better bankruptcy policy for debtors and creditors.

INTRODUCTION

Although the Bankruptcy Code (Code) provides the standard legal framework for bankruptcy for the entire nation, the laws are not always interpreted consistently. This disparity is particularly significant in the fraud exceptions to discharge in 11 U.S.C. § 523(a)(2). As a result of differing interpretations, debtors in some jurisdictions are prevented from discharging debts acquired through fraud, false pretenses, or misrepresentation,[1] while debtors in other jurisdictions might walk away from debts they obtained by dishonest means.[2] Preventing debts acquired by fraud from being discharged is of such importance that the principle was included in the earliest American bankruptcy laws.[3] This longstanding commitment to prohibiting debtors from shedding fraudulent debts through bankruptcy makes this disparate treatment of similar situations in different circuits especially alarming.

Consider the following situation: businessman Damien Debtor approaches Creditor Company and asks for a loan. He assures the company president that he can repay the company, telling her about the swanky office building in which he has an interest. The company agrees to the loan. Months later, Damien files for bankruptcy and seeks to discharge the debt he owes to Creditor Co. The worried president discovers, to her dismay, that Damien was dishonest about the office building. In fact, he has no significant assets and scores of liabilities. Now that Damien has filed for bankruptcy, however, he can discharge the debt owed to Creditor Co. and walk away, leaving Creditor Co. with the loss—or can he?

This hypothetical illustrates the importance of exceptions to discharge granted under the Code. In an ideal world, all debtors would be honest, hardworking folks with every intention of paying their debts, who just fell on hard times and need some help—though to be fair, in an ideal world no one would need to file for bankruptcy. The policy behind the Code was to aid such honest debtors by giving them an opportunity for a fresh start[4] while providing

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[1] *See, e.g.*, Bandi v. Becnel (*In re* Bandi), 683 F.3d 671 (5th Cir. 2012).

[2] *See, e.g.*, Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060 (4th Cir. 1984).

[3] *See* Anthony Michael Sabino, *Preventing an Alchemy of Evil: Preserving the Nondischargeability of a Debt Obtained by Fraud*, 12 J. BANKR. L. & PRAC. 99, 99 (2003).

[4] "A central feature of American consumer bankruptcy law is the 'fresh start' policy, which, through the dual mechanisms of discharge and exemption, affords debtors a certain degree of economic viability in exchange for the surrender of present assets at filing." Lawrence Ponoroff & Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235, 235 (1995).

fair treatment to their creditors.[5] Unfortunately, the world not being ideal, there are dishonest debtors like Damien who file for bankruptcy to avoid repaying debts they acquired through false representations, false pretenses, or other fraudulent means. To prevent this occurrence and protect creditors like Creditor Co., Congress enacted § 523(a)(2).[6]

Section 523 lists nineteen exceptions to discharge for individual debtors.[7] Subsection 523(a)(2) deals with fraud and misrepresentation.[8] More specifically, § 523(a)(2)(A), the fraud provision, prohibits individual debtors from discharging debts acquired through fraud or false pretenses.[9] Under this section an individual debtor may not discharge any debt acquired under "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's . . . financial condition."[10] The fraud provision does not specify whether statements of financial condition must be oral or written. Additionally, § 523(a)(2)(B), the false written statement provision, prohibits debtors from discharging debts obtained through materially false written statements "respecting the debtor's . . . financial condition" that were used with the intent to deceive.[11] The result of these provisions is that a debtor who acquires a debt through a false representation of his or her financial condition to a creditor may still discharge the debt through bankruptcy under certain circumstances.[12] However, what exactly constitutes a "statement respecting the debtor's or an insider's financial condition" is not clarified by the statute.[13]

The U.S. Courts of Appeals for the Fourth, Fifth, Eighth, and Tenth Circuits are divided on the proper interpretation of a "statement respecting the debtor's . . . financial condition" in the fraud provision and the false written statement provision.[14] There are two major viewpoints: the relaxed or broad

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[5] Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's Bankruptcy Decisions*, 3 CHAP. L. REV. 173, 187 (2000); Sabino, *supra* note 3, at 109–10 (citations omitted).

[6] *See* Sabino, *supra* note 3, at 111.

[7] 11 U.S.C. § 523 (2012).

[8] *Id.* § 523(a)(2).

[9] *Id.* § 523(a)(2)(A).

[10] *Id.*

[11] *Id.* § 523(a)(2)(B). The false written statement provision also requires that the creditor reasonably relied upon the statement. *Id.*

[12] *See id.* § 523(a)(2)(A)–(B).

[13] *Id.* § 523(a)(2)(A). Additionally, a financial condition is not defined in the definitions section of the Code. *See id.* § 101.

[14] *Compare* Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 676 (5th Cir. 2012), *and* Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 714 (10th Cir. 2005), *and* Rose v. Lauer (*In re* Lauer), 371 F.3d 406, 413 (8th Cir. 2004), *with* Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1060 (4th Cir. 1984).

interpretation and the strict or narrow interpretation.[15] Under the relaxed interpretation, a debtor's assertion that he owns specific properties free and clear constitutes a statement respecting the debtor's financial condition.[16] Courts that follow this interpretation hold that "a statement of the financial condition of even one asset qualifies under the statute and therefore the statement may not be used in a [§] 523(a)(2)(A) claim as evidence of false pretense, false representation or actual fraud."[17] The relaxed interpretation has the effect of making the fraud provision inapplicable in more situations—the more statements by a debtor are considered to be about his or her financial condition, the more a debtor can avoid the fraud exception to discharge.[18] Accordingly, a relaxed interpretation works in favor of the debtor and against the creditor. Under this standard, Damien's statement about his interest in the office building would qualify as a statement about his financial condition, and he would be able to discharge his debt to Creditor Co.[19]

Under the creditor-friendly strict interpretation, a statement respecting a debtor's financial condition must comprise the overall financial condition of the debtor for it to fall under the exception to discharge.[20] Under this viewpoint, the statement respecting the debtor's financial condition must pertain to the complete picture of the debtor's financial health—that is, to qualify for discharge under § 523(a)(2) (the fraud and the false written statement provisions—together, the fraud exception to discharge), the debtor must have falsely represented his or her complete financial situation to the creditor in order to receive the loan.[21] Because Damien only told the president of Creditor Co. about his ownership of a single asset—his interest in a specific office building—his declaration would not qualify as a statement about his

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[15] Joanna L. Radmall, Note, *Dishonest Debtors and Dischargeable Debts in Bankruptcy: An Analysis of the Circuit Split Regarding the Interpretation of 11 U.S.C. § 523(a)(2)'s Respecting the Debtor's . . . Financial Condition*, 2007 UTAH L. REV. 841, 841–42. The Fourth Circuit has espoused the relaxed interpretation and the Tenth and Fifth Circuits have adopted the strict interpretation. *See In re Bandi*, 683 F.3d at 676; *In re Joelson*, 427 F.3d at 714; *In re Van Steinburg*, 744 F.2d at 1060–61.

[16] *See In re Van Steinburg*, 744 F.2d at 1060 (citing Nagin v. Pollina (*In re* Pollina), 31 B.R. 975 (D.N.J. 1983)).

[17] Radmall, *supra* note 15, at 846 (citations omitted); *see In re Van Steinburg*, 744 F.2d at 1060–61.

[18] If it is a written statement, it might fall under the false written statement exception to discharge, but only if the debt meets all of the requirements of that subsection. Any and all fraudulent oral statements regarding the debtor's financial condition will allow the debtor to escape liability.

[19] He may, of course, be denied discharge of the debt to Creditor Co. under other provisions of the Code, such as the bad faith provision. 11 U.S.C. § 707(b)(3)(A) (2012).

[20] *In re Bandi*, 683 F.3d at 676.

[21] Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 714 (10th Cir. 2005).

financial condition, and Creditor Co. could prevent him from discharging the debt.

Part I of this Comment provides an overview of the fraud provision and the history of the circuit split. Part II conducts statutory interpretation of the fraud and the false written statement provisions to discern the proper meaning of "statement respecting the debtor's . . . financial condition."[22] Part III will discuss why, based on statutory interpretation and public policy, the correct reading of "a statement respecting the debtor's . . . financial condition" is a statement that concerns the debtor's overall financial health, as opposed to a statement concerning the debtor's ownership of certain items of property.[23] This Comment recommends that courts should abandon the broad interpretation because it results in poor bankruptcy policy. It proposes adding a definition of "financial condition" to § 101 to clarify that the meaning of "financial condition" is the overall financial health of the debtor.

I. BACKGROUND

The bankruptcy laws of the United States have a long history of preventing the discharge of debts acquired through fraud or deceit.[24] Section A describes the background and history of the fraud and false written statement provisions in § 523(a)(2). Section B explains the history and progression of the circuit split that exists today over the proper meaning of "statement respecting the debtor's . . . financial condition."[25]

A. The History of the Fraud Provision

Section 523 of the Code, "Exceptions to discharge," lists nineteen categories of debts that individual debtors may not discharge in bankruptcy.[26]

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22 *See generally* 11 U.S.C. § 523(a)(2)(A)–(B).

23 *See generally id.*

24 Sabino, *supra* note 3.

25 *See generally* 11 U.S.C. § 523(a)(2).

26 *Id.* § 523(a)(1)–(19). The general categories are as follows: tax and customs duties; debts obtained fraudulently; debts not listed in the bankruptcy schedules; debts due to fraud or defalcation by fiduciaries; domestic support obligations; debts for willful and malicious torts by the debtor; certain government fines; certain educational debts; debts resulting from operating a motor vehicle while intoxicated; debts for which the debtor was denied or for which the debtor waived discharge; judgment debts for defrauding a depository institution; debts for malicious or reckless failure to fulfill a commitment to a federal depository institution; orders to pay restitution under title 18 of the U.S. Code; federal taxes; debts relating to divorce or separation agreements; homeowners association fees; prisoners' court fees; employment debts; and fines or judgments for violation of federal securities laws. *Id.*

The categories make up four distinct groups: "(i) governmental liabilities, (ii) liabilities incurred through fault, (iii) obligations arising from divorce or separation agreement, and (iv) liabilities excepted for purposes related to bankruptcy administration."[27] Section 523(a)(2) prohibits an individual debtor from discharging debts:

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; [or]
>
> (B) use of a statement in writing—
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
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> (iv) that the debtor caused to be made or published with intent to deceive[.][28]

Although the phrase "a statement respecting the debtor's . . . financial condition" is used in both subsections, the term is not defined in § 523.[29]

The Bankruptcy Act of 1898, the first permanent federal bankruptcy legislation, "ushered in the modern era of liberal debtor treatment in United States bankruptcy laws. While the earlier laws had allowed a debtor a discharge, many restrictions qualified that privilege."[30] The Act made it much easier for debtors to receive discharges and limited creditors' power to object to discharge.[31] Despite the fact that the legislation "severely limited the number of grounds for denial of discharge,"[32] debtors were still not permitted to discharge debts obtained through fraud or false pretenses.[33]

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[27] 3 WILLIAM L. NORTON JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE § 57:1 (3d ed. 2014) (citations omitted).

[28] 11 U.S.C. § 523(a)(2)(A)–(B).

[29] *Id.* § 523.

[30] Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 24 (1995) (citations omitted).

[31] *Id.*

[32] *Id.*

[33] Bankruptcy Act of 1898, Pub. L. No. 696, § 17, 30 Stat. 544, 550–51 (repealed 1978) (superseded by 11 U.S.C. § 523(a) (2012)).

In 1903 Congress amended the Bankruptcy Act to permit judges to disallow discharge in situations where the debtor acquired credit or property from a creditor through a "materially false statement in writing."[34] This alteration indicated further tightening of restrictions for discharge where fraud was involved. In 1960, Congress backed off and amended the law to permit some discharge for debts obtained through fraud.[35] The amended portion stated that debts should not be dischargeable for:

> liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property . . . in reliance upon a materially false statement in writing respecting [the debtor's] financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive[.][36]

In 1978, Congress reworded the fraud provision to its present state and re-codified it as § 523(a)(2)(A).[37]

B. The Circuit Split

The U.S. Courts of Appeals have split regarding the correct interpretation of the phrase "a statement respecting the debtor's . . . financial condition" as it appears in the fraud and the false written statement provisions.[38] In 1984, the U.S. Court of Appeals for the Fourth Circuit dealt with the issue in *Engler v. Van Steinburg (In re Van Steinburg)*.[39] In this case, the debtor sought to discharge a debt of $5,500 he obtained from a creditor by providing what he claimed was a priority security interest in property the debtor knew was already subject to superior liens.[40] The court interpreted the term "financial condition" broadly, finding that a "debtor's oral misrepresentations that he owned the property free and unencumbered related to his financial condition"

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[34] Act of Feb. 5, 1903, Pub. L. No. 57-62, ch. 487, sec. 4, § 14(b), 32 Stat. 797, 797–98 (repealed 1978) (amending Bankruptcy Act of 1898).

[35] Act of July 12, 1960, Pub L. No. 86-621, sec. 2, §17(a), 74 Stat. 408, 409 (repealed 1978) (amending Bankruptcy Act of 1898).

[36] *Id.*

[37] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2590 (codified at 11 U.S.C. § 523 (2012)).

[38] Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 676–77 (5th Cir. 2012).

[39] Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060 (4th Cir. 1984).

[40] *Id.* at 1060.

and thus fell within the exception to the fraud provision.[41] *Van Steinburg* remains good law in the Fourth Circuit.[42]

The Tenth Circuit encountered the interpretation question in *Cadwell v. Joelson (In re Joelson)*. In the case, the debtor obtained a loan from the creditor by telling him that she owned several properties, and even drove him to the properties she claimed to own.[43] After conducting an extensive analysis of the statute, legislative history, and the decisions of other courts, the Tenth Circuit strictly interpreted "statements respecting the debtor's financial condition" as "[s]tatements that present a picture of a debtor's overall financial health include those analogous to balance sheets, income statements, statements of changes in overall financial position, or income and debt statements that present the debtor or insider's net worth, overall financial health, or equation of assets and liabilities."[44] Because the debtor's oral statements pertained only to certain items of property she claimed to own, the court found that the exception to the fraud provision did not apply; thus, the debt was nondischargeable.[45]

Recently, the Fifth Circuit had to interpret "financial condition." The court sided with the Tenth Circuit, adopting the strict interpretation of the phrase in *Bandi v. Becnel (In re Bandi)*.[46] The debtors, two brothers, falsely represented to the creditor that they owned specific properties to obtain a loan of $150,000.[47] After the debtors filed for chapter 7, the creditor brought an adversary proceeding against them to prevent the discharge of the debt.[48] The bankruptcy court held that because the debt was acquired through false representations, it was nondischargeable under the fraud provision.[49] The Fifth Circuit affirmed the judgment of the bankruptcy court, agreeing with the Tenth

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41 *Id.*

42 *See* Stvan v. Mona (*In r*e Mona), No. 11-28112, 2013 WL 4017126, at *10 & n.9 (Bankr. D. Md. Aug. 6, 2013); *see also* EagleBank v. Korman (*In re* Korman), No. 09-13311, 2012 WL 4467628, at *8 (Bankr. D. Md. Sept. 26, 2012) (citing *In re Van Steinburg*, 744 F.2d 1060); Lawyers Title Ins. Co. v. Chesson (*In re* Chesson), No. B-09-81328C, 2012 WL 4794148, at *7 (Bankr. M.D.N.C. Oct. 9, 2012) (citing *In re Van Steinburg*, 744 F.2d at 1060–61).

43 Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 703 (10th Cir. 2005).

44 *Id.* at 713–14 ("However . . . . What is important is not the formality of the statement, but the information contained within it—information as to the debtor's or insider's overall net worth or overall income flow.").

45 *Id.* at 714–15.

46 Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 676, 677 (5th Cir. 2012) (citing *In re Joelson*, 427 F.3d at 710, 714).

47 *Id.* at 673.

48 *Id.*

49 *Id.*

Circuit's interpretation of financial condition in *Joelson*.[50] The court reasoned that the strict interpretation was appropriate in light of the statute's purpose and wording, as interpreted by the Supreme Court in *Field v. Mans*.[51] In that case, "the Court seemed to equate a 'statement' about 'financial condition' with what is commonly understood as something akin to a balance sheet or bank balance."[52] The Fifth Circuit ultimately held that "[t]he term 'financial condition' . . . mean[t] the general overall financial condition of an entity or an individual, that is, the overall value of property and income as compared to debt and liabilities."[53]

The Second, Seventh, and Eighth Circuits have also heard cases involving the interpretation of "financial condition" in the fraud and the false written statement provisions, but have not been directly decided the issue.[54] In *Schneiderman v. Bogdanovich (In re Bogdanovich)*, the Second Circuit recognized the lower court division regarding the competing relaxed and strict interpretations.[55] It declined to take a position on the matter, however, finding it unnecessary in the present case.[56] In *Berkson v. Gulevsky (In re Gulevsky)*, the Seventh Circuit briefly addressed the issue, but it was not relevant to the court's decision.[57] In *Rose v. Lauer (In re Lauer)*, the Eighth Circuit encountered the issue incidentally to the problem at hand. Although the court did not take time to interpret the wording of "statement respecting the debtor's . . . financial condition" in § 523(a)(2), it seemed to construe the phrase in accordance with the strict interpretation.[58]

In jurisdictions where the court of appeals has not ruled on the proper interpretation of "financial condition" in the fraud and false written statement

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[50] *Id.* at 677.

[51] *Id.* at 675–76 (citing Field v. Mans, 516 U.S. 59, 76–77 (1995) ("The House Report on the [Bankruptcy] Act suggests that Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge.")).

[52] *Id.* at 675 (citing *Field*, 516 U.S. at 76).

[53] *Id.* at 676.

[54] *See* Berkson v. Gulevsky (*In re* Gulevsky), 362 F.3d 961, 962–64 (7th Cir. 2004); Rose v. Lauer (*In re* Lauer), 371 F.3d 406, 413–14 (8th Cir. 2004) (citations omitted); Schneiderman v. Bogdanovich (*In re* Bogdanovich), 292 F.3d 104, 113 (2d Cir. 2002).

[55] *In re Bogdanovich*, 292 F.3d at 112–13 (citations omitted).

[56] *Id.* at 113. In the *Bogdanovich* case the issue of how to interpret "financial condition" was raised, but the court did not explicitly decide the issue. *Id.* at 113–14.

[57] *In re Gulevsky*, 362 F.3d at 962–64.

[58] *See In re Lauer*, 371 F.3d at 413–14 (citations omitted).

provisions, lower courts have gone both ways—for example, some judges in the Southern District of New York have followed the narrow interpretation while others have followed the broad one.[59] In addition, a few bankruptcy courts have adopted a "modified-expansive view" which they assert differs from both the narrow and broad interpretations of the circuit courts.[60] These courts concentrate on the facts of a given case and the purpose for which the statement was made or given.[61] According to one author, "Courts espousing this view consider whether the single asset or liability about which the debtor made the misrepresentation 'materially affect[s] the debtor's . . . overall financial condition' and is 'made for the purpose of demonstrating financial wherewithal to pay a debt or perform a contract.'"[62] Essentially, courts that have adopted the modified-expansive view prefer to look at the facts of each case instead of using a bright line test for the interpretation of "financial condition."[63] This approach involves examination of both the statement and the purpose for which it was made.[64] Only a few bankruptcy courts, and no circuit courts, have adopted this modified-expansive approach.[65]

As a result of the ambiguity of the phrase "financial condition" in the fraud and false written statement provisions, both bankruptcy and circuit courts remain at an impasse. Courts interpret the term differently, leading to different results in similar circumstances. If this issue of conflicting readings goes before the Supreme Court, or is dealt with by Congress, the primary solution

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[59] *Compare* Weiss v. Alicea (*In re* Alicea), 230 B.R. 492 (Bankr. S.D.N.Y. 1999) (Judge Bernstein applying the strict interpretation), *with* Hudson Valley Water Res., Inc. v. Boice (*In re* Boice), 149 B.R. 40 (Bankr. S.D.N.Y. 1992) (Judge Berk applying the relaxed interpretation).

[60] *See* Radmall, *supra* note 15, at 845, 848–51 (citations omitted).

[61] *See, e.g.*, Norcross v. Ransford (*In re* Ransford), 202 B.R. 1, 4 (Bankr. D. Mass. 1996).

[62] Radmall, *supra* note 15, at 848 (quoting *In re Alicea*, 230 B.R. at 503 n.8).

[63] *See generally id.* at 848–51.

[64] *In re Ransford*, 202 B.R. at 4. The Bankruptcy Court for the Southern District of New York summarized the modified-expansive approach thusly:

> Some courts have articulated a third, functional approach which examines the nature of the statement and the purpose for which it is sought and made. Where the statement relates only to a single asset or liability, the asset or liability must materially affect the debtor's (or insider's) overall financial condition and be made for the purpose of demonstrating financial wherewithal to pay a debt or perform a contract. This seems simply to restate the broad view of § 523(a)(2)(B). It considers the materiality of the statement regarding a single asset or liability in determining whether it concerns the debtor's financial condition. Materiality is already an element of the fraud claim.

In re Alicea, 230 B.R. at 503 n.8 (citations omitted).

[65] *See* Radmall, *supra* note 15, at 845, 848–51 (citations omitted). *See generally In re Alicea*, 230 B.R. at 504; *In re Ransford*, 202 B.R. at 4.

should be to conduct statutory interpretation to determine the correct meaning of the ambiguous language.

II. STATUTORY INTERPRETATION OF "FINANCIAL CONDITION" IN THE FRAUD AND FALSE WRITTEN STATEMENT PROVISIONS

When the language of a statute is unclear, courts engage in statutory interpretation to clarify it.[66] There are many tools of statutory construction that gain and lose favor with courts over time.[67] However, some disfavor statutory interpretation, believing that it unnecessarily complicates the law.[68] Indeed, the Supreme Court has emphasized that statutory interpretation should only be employed when the plain or semantic meaning of the text is unclear.[69] However, in cases where there is ambiguity in statutory language, "accepted rules of statutory construction can provide helpful guidance in uncovering the most likely intent of Congress."[70] The Court has frequently used certain maxims of statutory construction deciding bankruptcy cases.[71]

Statutory interpretation is not conducted in a vacuum. Judges who engage in statutory interpretation use various approaches that affect which tools they use.[72] Consequently, the judge's approach to statutory interpretation has a considerable effect on how the interpretation is conducted. The approach determines which methods the judge will employ and in what order. The background of the judge engaging in statutory interpretation will always have an effect on the outcome of the interpretation.[73] As a result, an understanding

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[66] The term 'statutory interpretation' itself is used to refer, on the one hand, solely to the cognitive process of ascertaining meaning and, on the other hand, to the entire process by which a court discharges its responsibility of applying statutes to specific controversies. It is hard to tell which sense is being used on which occasion. REED DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 1–2 (1975).

[67] *See, e.g.*, JOHN F. MANNING & MATTHEW C. STEPHENSON, LEGISLATION AND REGULATION 140–42 (2010).

[68] "A text should not be construed strictly, and it should not be construed leniently; it should be construed reasonably to contain all that it fairly means." ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 23 (1997).

[69] *See, e.g.*, Jay v. Boyd, 351 U.S. 345 (1956).

[70] N.J. Air Nat'l Guard v. Fed. Labor Relations Auth., 677 F.2d 276, 285 (3d Cir. 1982).

[71] KENNETH N. KLEE, BANKRUPTCY AND THE SUPREME COURT 15–22 (2008).

[72] *See* MANNING & STEPHENSON, *supra* note 67, at 137.

[73] *See id.* "Judges answer many questions of the linguistically correct meaning of particular words out of their own experience and judgment." *Id.* (quoting HENRY M. HART, JR. & ALBERT M. SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW 1190 (1994)).

of the approach used by a judge is important in understanding how he or she carried out statutory interpretation.[74]

This Comment employs some of the most widely accepted and commonly used tools of statutory construction in bankruptcy cases[75] to show that the correct reading of the term "a statement . . . respecting the debtor's . . . financial condition" is a statement that concerns the debtor's overall financial health, as opposed to a statement concerning the debtor's ownership of certain items of property.[76] Each of the following sections analyzes the meaning of the statute using a specific tool of statutory construction. Section A examines the text of the statute, including its ordinary, dictionary, and plain meanings. Section B focuses on the structure of the statutory language. Section C uses canons of construction to interpret the meaning of the statute. Section D examines the legislative history of the fraud provision to determine legislative intent. Section E concentrates on the public policy rationales advanced by proponents of the strict and relaxed interpretations.

A. Text

The Supreme Court has emphasized that the text itself should always be the starting point when conducting statutory interpretation.[77] At times, the text has an easily discernible meaning that a court can then apply to the facts of a particular case. However, determining the meaning of the text is not always a straightforward process.[78] Congress is not a single-minded entity, but rather a group of diverse individuals with conflicting viewpoints.[79] When legislators disagree on what the law should be, they may compromise by wording the statute so as to leave the law ambiguous.[80] When this happens, "a specific application will require judicial interpretation."[81] Of course, a statute may be unclear for reasons other than legislative compromise. Words lack fixed meanings; their meanings change depending on who uses them and for what

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[74] For an explanation of what tools are favored by the different approaches, see Theo I. Ogune, *Judges and Statutory Construction: Judicial Zombism or Contextual Activism?*, 30 U. BALT. L.F. 4 (2000).

[75] Kenneth Klee has compiled a list of seventeen maxims of statutory construction frequently used by the Supreme Court in deciding bankruptcy cases. KLEE, *supra* note 71, at 15–22.

[76] *See generally* 11 U.S.C. § 523(a)(2) (2012).

[77] United States v. Ron Pair Enters., 489 U.S. 235, 241 (1989) (citing Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985)).

[78] MANNING & STEPHENSON, *supra* note 67, at 111.

[79] *See* Courtney Simmons, *Unmasking the Rhetoric of Purpose: The Supreme Court and Legislative Compromise*, 44 EMORY L.J. 117, 117–18 (1995).

[80] *See id.*

[81] *Id.* at 118.

purpose.[82] Whatever the reason for vagueness in a statute, courts turn to tools of statutory interpretation to understand the statute's meaning when ambiguity arises.[83]

1. Ordinary Usage

The first step of textual analysis is usually to construe the ambiguous term in accordance with its ordinary usage or meaning.[84] "In the circumstances in which a word is used, the ordinary meaning is . . . the meaning people generally intend to convey when they use that word in circumstances like those."[85] In this case, because the term "statement respecting the debtor's . . . financial condition" is located in the Code, it should be interpreted in accordance with its ordinary use in the context of bankruptcy proceedings.

Courts accept that "[t]he ordinary usage of 'statement' in connection with 'financial condition' denotes either a representation of a person's overall 'net worth' or a person's overall ability to generate income."[86] That is, financial condition is an overview of the debtor's financial health as a whole.[87] Statements that show a debtor's assets and liabilities, or that showcase his or her net worth, may qualify under this definition.[88] A statement about the debtor's ownership of one or more specific items of property would not provide a picture of the debtor's overall financial status, and thus would not qualify under the accepted ordinary meaning of financial condition as interpreted by courts.

Ordinary usage may be in part derived from a dictionary definition.[89] Although the use of dictionary definitions has been criticized, many courts agree that they are a useful starting point when determining the meaning of a

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82 *See* Cornelio v. Consol. Rail Corp., 585 F. Supp. 490, 492 (D. Conn. 1984) (citation omitted).

83 "The meaning to be ascribed to an Act of Congress can only be derived from a considered weighing of every relevant aid to construction." United States v. Dickerson, 310 U.S. 554, 562 (1940).

84 73 AM. JUR. 2D *Statutes* § 67 (2014) (citations omitted).

85 LAWRENCE M. SOLAN, THE LANGUAGE OF STATUTES: LAWS AND THEIR INTERPRETATION 53 (2010).

86 Jokay Co. v. Mercado (*In re* Mercado), 144 B.R. 879, 885 (Bankr. C.D. Cal. 1992). In a similar case, another court recognized that "financial statement" was not defined in the Code, but interpreted the term in accordance with its ordinary meaning in a business setting: "the typical balance sheet (assets and liabilities) and profit and loss statement . . . ." D. Nagin Mfg. Co. v. Pollina (*In re* Pollina), 31 B.R. 975, 978 (D.N.J. 1983).

87 *See In re Mercado*, 144 B.R. at 885.

88 *In re Pollina*, 31 B.R. at 978.

89 73 AM. JUR. 2D, *supra* note 84 (citation omitted). However, dictionary definition and ordinary meaning are not always compatible. "The definition of words in isolation . . . is not necessarily controlling in statutory construction." Dolan v. U.S. Postal Serv., 546 U.S. 481, 486 (2006); *see also* SOLAN, *supra* note 85, at 54.

statute.[90] Black's Law Dictionary directs one looking up "statement of financial condition"[91] to the entry for "balance sheet," which is defined as "[a] statement of an entity's current financial position, disclosing the value of the entity's assets, liabilities, and owners' equity."[92] A balance sheet has two variables: assets and liabilities/equity.[93] Logically, a statement about an individual's assets fails to give a complete picture of financial condition, as it leaves out the aspect of liabilities. A definition that incorporates both assets and liabilities incorporates the totality of the entity's financial status. This interpretation favors the strict view held by the Tenth and Fifth Circuits.[94]

Although words in statutes are presumed to have their ordinary meanings, this rule is not absolute. If interpreting statutory language in accordance with common usage is adverse to the intent of the legislature, the language should be interpreted differently.[95] Ordinary meaning may be disregarded if there is clear legislative intent "against enforcement according to the letter."[96] The Supreme Court has held that "there are times when the mere letter of a statute does not control, and that a fair consideration of the surroundings may indicate that that which is within the letter is not within the spirit, and therefore must be excluded from its scope."[97] However, for the ordinary meaning to be superseded, there must be some proof that clearly shows the intent of Congress is in conflict with that meaning.[98]

While the Fourth Circuit concluded a debtor's statement that his or her specific property was unencumbered by liens constituted a statement respecting that debtor's financial condition, the court recognized that this interpretation was not the ordinary one.[99] The court justified its departure from the term's ordinary meaning by relying on legislative intent.[100] It pointed out

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90 *See, e.g.*, Alaskans for Efficient Gov't, Inc. v. Knowles, 91 P.3d 273, 276 (Alaska 2004).

91 BLACK'S LAW DICTIONARY 1540 (9th ed. 2009).

92 *Id.* at 163.

93 Eric J. Zinn, *Taxation of LLCs and the Use of Balance Sheets: An Introduction*, COLO. LAW., Jan. 2011, at 75.

94 *See* Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 676 (5th Cir. 2012); Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 714–15 (10th Cir. 2005).

95 *See* Treat v. White, 181 U.S. 264, 267–68 (1901).

96 *Id.*

97 *Id.* (citing Church of the Holy Trinity v. United States, 143 U.S. 457 (1892)).

98 *See id.*

99 Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1060 (4th Cir. 1984) ("Concededly, a statement that one's assets are not encumbered is not a formal financial statement in the ordinary usage of that phrase.").

100 *See id.* at 1060–61.

that Congress did not use the term "financial statement," but rather the phrase "respecting the debtor's . . . financial condition."[101] The court reasoned that this choice of phrase indicated that Congress was referring "to a much broader class of statements . . . ."[102]

Although the Fourth Circuit claimed that its interpretation was based on congressional intent, it failed to include citations to relevant legislative documents.[103] However, at least one court has found "nothing in the legislative history indicates that § 523(a)(2)(B) should be expanded beyond statements about a debtor's net worth or overall earning capacity."[104] In the absence of clear legislative intent or other compelling proof to the contrary, courts may not deviate from the ordinary meaning of the term.[105] As a result, the Fourth Circuit was not justified in deviating from the ordinary meaning of "statement respecting the debtor's . . . financial condition."[106]

Closely associated with ordinary meaning is plain meaning. While the two tend to go hand in hand, they are distinct. The next section builds off the analysis of ordinary meaning to show that the plain meaning of "financial condition" also supports a strict interpretation.

2. Plain Meaning

The Supreme Court has frequently relied on the plain meaning rule to resolve issues of statutory interpretation in bankruptcy cases.[107] Courts have expressed this rule in numerous ways in a variety of cases, but generally hold that where statutory language is straightforward and unambiguous, the plain meaning of the text must be applied.[108] The plain meaning rule tends to be one of the first tools chosen by the Supreme Court when conducting statutory interpretation in bankruptcy cases.[109] To determine plain meaning, courts consider what the provision would indicate to an ordinary, reasonable person, "given the ordinary meanings of words and accepted precepts of grammar and

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101 *Id.* at 1061.

102 *Id.*

103 *Id.* 744 F.2d 1060; Jokay Co. v. Mercado (*In re* Mercado), 144 B.R. 879, 883 (Bankr. C.D. Cal. 1992).

104 *In re Mercado*, 144 B.R. at 883. For an in-depth examination of the legislative history surrounding § 523(a)(2)(A) and (B), see *infra*, Part D.

105 *See* Treat v. White, 181 U.S. 264, 268 (1901).

106 *See generally* 11 U.S.C. § 523(a)(2)(A)–(B) (2012).

107 KLEE, *supra* note 71, at 15; *see also* Thomas G. Kelch, *An Apology for Plain-Meaning Interpretation of the Bankruptcy Code*, 10 BANKR. DEV. J. 289 (1994).

108 Am. Tobacco Co. v. Patterson, 456 U.S. 63, 68 (1982).

109 KLEE, *supra* note 71, at 15.

syntax . . . ."[110] However, whether a statute's language is clear and unambiguous is often a matter of debate itself.[111]

The circuit split at the federal appellate level and the division among lower courts indicate that the term "statement . . . respecting the debtor's . . . financial condition" as it appears in the fraud and the false written statement provisions is undoubtedly ambiguous.[112] The statute does not provide any guidance on what constitutes someone's "financial condition."[113] None of the courts that have used tools of statutory interpretation to analyze the meaning of a "statement respecting the debtor's . . . financial condition" have used the plain meaning rule in their analyses.[114]

Although no courts have employed it, there may be an argument that the plain meaning rule supports an interpretation of the phrase that is consistent with the strict view. To determine the plain meaning of a statute, the "starting point is 'the ordinary meaning of the words used.'"[115] As previously discussed, the ordinary meaning of the term "statement respecting the debtor's financial condition" is a statement about the debtor's overall financial health.[116] Using the plain meaning approach, one can therefore conclude that the plain meaning of the term is a statement encompassing the totality of the debtor's financial status.

This section supports the claim that the language of the statute favors a strict interpretation. Further tools of statutory interpretation will provide additional proof that a strict reading of the statute is the correct one. The next section analyzes the structure of the statute and discusses why it, like the text itself, supports a strict interpretation.

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110 WILLIAM N. ESKRIDGE, JR., DYNAMIC STATUTORY INTERPRETATION 38 (1994).

111 *See, e.g.*, United States v. Ron Pair Enters., 489 U.S. 235, 250–51 (1989) (O'Connor, J., dissenting).

112 *See* 11 U.S.C. § 523(a)(2)(A)–(B) (2012); Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 708–09 (10th Cir. 2005); Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1060–61 (4th Cir. 1984).

113 *See* 11 U.S.C. § 523(a)(2)(A).

114 *See, e.g.*, Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 676 (5th Cir. 2012); *In re Joelson*, 427 F.3d at 714.

115 United States v. Geiser, 527 F.3d 288, 294 (3d Cir. 2008) (quoting Appalachian States Low-Level Radioactive Waste Comm'n v. Pena, 126 F.3d 193, 197 (3d Cir. 1997)).

116 *See* D. Nagin Mfg. Co. v. Pollina (*In re* Pollina), 31 B.R. 975, 978 (Bankr. D.N.J. 1983).

B. Structure

After the text, the statute's structure is the next area a court examines in conducting statutory interpretation.[117] Indeed, the structure of the statute is often examined in conjunction with the text. Nevertheless, it is a distinct, though related, component of the statute and deserves a separate analysis.

The structure of § 523 supports the strict interpretation of "financial condition."[118] Under the statute, statements respecting the debtor's financial condition are treated differently under the fraud provision than under the false written statement provision.[119] If a debtor made a false statement about his financial condition to obtain money, property, services, or credit under the statute, whether orally or in writing, he might still be able to discharge the debt under the fraud provision.[120] Conversely, under the false written statement provision, debts acquired through written statements falsely representing the debtor's financial condition are nondischargeable, provided that they are also materially false, the debtor made them intending to deceive, and the creditor reasonably relied on them.[121]

Table 1 below summarizes the effect of the strict and relaxed interpretations of "statement respecting the debtor's . . . financial condition" in both the fraud and false written statement provisions.[122] Under the strict approach, in which a statement about specific assets ("discrete statement") does not constitute a statement about financial condition, a debt obtained by such a statement is potentially nondischargeable. If the statement was not about financial condition, then the false written statement provision would not apply. Under the relaxed approach, a discrete statement would qualify as a statement about financial condition, so the fraud provision would not apply. However, the false written statement provision may still apply.

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117 *See* Zogbi v. Federated Dep't Store, 767 F. Supp. 1037, 1039 (C.D. Cal. 1991).
118 *In re Joelson*, 427 F.3d at 707.
119 *Id.*
120 *Id.*
121 11 U.S.C. § 523(a)(2)(B) (2012).
122 *See generally id.* § 523(a).

Table 1

	Strict Approach (Creditor-Friendly) **Discrete statement ≠ statement about financial condition**	**Relaxed Approach (Debtor-Friendly)** **Discrete statement = statement about financial condition**
§ 523(a)(2)(A) – Fraud Provision	Potentially nondischargeable (no writing required)	Does not apply
§ 523(a)(2)(B) – False Written Statement Provision	Does not apply	Potentially nondischargeable (writing required)

By interpreting the phrase "statement respecting the debtor's . . . financial condition" to mean a statement regarding a debtor's overall financial position, the statute makes perfect sense. It would be reasonable for the statute to permit a debtor who orally misrepresented his overall financial position to discharge the debt because she might accidentally omit some pertinent information when listing everything aloud.[123] When focusing on a particular item of property, it is much less likely that the debtor would forget or misspeak.[124] Similarly, it seems unlikely that a debtor who lays out his financial position in writing would make an error. If the term were construed broadly, a debtor who made an oral misrepresentation about her interest in any item of property would be able to discharge the debt through bankruptcy.[125] However, a debtor who misrepresented her ownership of any particular property in writing would not be able to discharge the debt under the false written statement provision, assuming that the other conditions of the provision were satisfied. Such a reading is not as logical, or as consistent with the purpose of the statute, as a reading in accordance with the strict interpretation.

Although a statute's text and structure are the starting points in statutory interpretation, there are other tools and methods used by courts to determine the proper meaning of statutory language. The next section considers canons of

123 *In re Joelson*, 427 F.3d at 707.
124 *Id.*
125 *See generally* 11 U.S.C. § 523(a)(2)(A)–(B).

construction. While not universally accepted like the text, canons are an important tool in statutory construction.[126] The Supreme Court regularly considers certain canons when conducting statutory interpretation in bankruptcy cases.[127] There are myriad canons, but only those most relevant to the statute and most commonly used by the Court in bankruptcy decisions are analyzed below.

C. Canons of Construction

Like the text and structure, canons of construction are frequently used by judges in statutory interpretation.[128] Although the use of canons has been criticized by some,[129] courts continue to employ them.[130] Canons have many functions; they "operate as tiebreakers in close cases; as presumptions of statutory meaning that can be rebutted only if inconsistent with other signals; or as clear statement rules that can be negated only be statutory text to the contrary."[131] It is important to note that there is no set of rules that outline which canons should be used or when they should be relied upon.[132] Instead, courts have complete discretion over which to apply or whether to apply them at all.[133] This Comment uses three canons to interpret the statute. First, it applies the canon that presumes uniform usage of a term throughout the entire statute. Second, it uses the canon of avoidance of internal inconsistency. Third, it applies the canon of avoidance of redundancy. These canons were selected

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126 KENT GREENAWALT, LEGISLATION: STATUTORY INTERPRETATION: 20 QUESTIONS 201 (1999).

127 KLEE, *supra* note 71, at 15–22.

128 GREENAWALT, *supra* note 126, at 201. "Canons of construction are judicially crafted maxims for determining the meaning of statutes." ABNER J. MIKVA & ERIC LANE, AN INTRODUCTION TO STATUTORY INTERPRETATION AND THE LEGISLATIVE PROCESS 23 (1997). They have also been defined as "interpretative tools, which are no more than rules of thumb that help the court determine the meaning of legislation; canons assist the court in determining the meaning of particular statutory provisions by focusing on the broader, statutory context." 73 AM. JUR. 2D, *supra* note 84, § 60. In a 1992 case, the Supreme Court defined them as "no more than rules of thumb that help courts determine the meaning of legislation . . . ." Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992).

129 *See, e.g.*, James J. Brudney & Corey Ditslear, *Canons of Construction and the Elusive Quest for Neutral Reasoning*, 58 VAND. L. REV. 1, 7 (2005).

130 MIKVA & LANE, *supra* note 128, at 27.

131 ESKRIDGE, JR., *supra* note 110, at 148–49. "The function of statutory construction is to ascertain the intent of the legislature in enacting a statute, i.e. the purpose and objectives of the legislation. The rules or canons of statutory construction are tools or aids for determining that intent or purpose." Craig A. Sullivan, *Statutory Construction in Missouri*, 59 J. MO. B. 120, 120 (2003).

132 *See* Brudney & Ditslear, *supra* note 129, at 7.

133 "Federal judges regularly exercise broad discretion in deciding when the canons should apply, which ones to invoke in a particular setting, and how to reconcile them with other contextual resources . . . ." *Id.* For this reason, it has been noted that judges can pick and choose canons that support whatever outcome they believe best or most appropriate. MIKVA & LANE, *supra* note 128, at 25.

because they are the most appropriate to the interpretation of the fraud and the false financial statement provisions, based on the statute's wording and structure.

1. Presumption of Uniform Usage

One canon that is useful in the interpretation of "financial condition" is the presumption of uniform usage. This canon holds that when the same word or phrase is used multiple times in the same statute, there is a presumption that the terms have the same meaning.[134] In this case, the phrase "statement respecting the debtor's . . . financial condition" appears in only two parts of the Code: the fraud provision and the false written statement provision. As a result, it is presumed that the phrase "statement respecting a debtor's . . . financial condition" has the same meaning in both of the two subsections.

Although "financial condition" does not appear again in the rest of § 523, the term is also found in § 101(32) as part of the definition of "insolvent."[135] That section defines insolvent as "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation[.]"[136] The definition's use of "sum of such entity's debts" and "all of such entity's property" shows that financial condition is determined by looking at the financial status of the entity as a whole.[137] By referring to the entirety of the entity's debts and assets, this wording takes into account the entirety of the entity's financial situation.[138] This usage of "financial condition" is consistent with the strict interpretation of that term adopted by the Tenth and Fifth Circuits—the debtor's overall financial status.[139]

Applying the canon of uniform usage, one can deduce that "financial condition" in the fraud and the false written statement provisions has the same meaning as it does in § 101(32)(A)—that is, a debtor's financial condition relates to the totality of his or her assets and liabilities.[140] A debtor's total assets and liabilities show his or her complete financial circumstance. Thus, the

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134 Atl. Cleaners & Dyers v. United States, 286 U.S. 427, 433 (1932); *see generally* Jonathan R. Macey & Geoffrey P. Miller, *The Canons of Statutory Construction and Judicial Preferences*, 45 VAND. L. REV. 647, 650 (1992).

135 11 U.S.C. § 101(32)(A) (2012).

136 *Id.*

137 *See id.*

138 *See id.*

139 *See, e.g.*, Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 673–75 (5th Cir. 2012); Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 708–09 (10th Cir. 2005).

140 *Compare* 11 U.S.C. § 101(32)(A), *with id.* § 523(a).

meaning of "statement respecting the debtor's . . . financial condition" in the fraud and the false written statement provisions has been correctly interpreted by courts that have adopted the strict interpretation.

The fact that "financial condition" appears as part of the definition of insolvent but is not given its own definition is somewhat puzzling. If Congress had included a definition of financial condition, perhaps as a subpart of the definition of insolvent, then the circuit split may have been avoided. It would be helpful if Congress clarified the Code to include a definition of financial condition. This idea is discussed further in Part III.

2. Avoidance of Internal Inconsistencies

Another canon of construction relevant to this statutory interpretation holds that "[a] statute should be read to avoid internal inconsistencies."[141] This canon stipulates that when there is confusion over the meaning of words or sentences, they should be interpreted in a manner consistent with the rest of the statute.[142] The ambiguous part of the statute should be construed in a way that makes sense within the context of the entire statute.[143]

In the present situation, the ambiguous language—"statement respecting a debtor's . . . financial condition" can be interpreted in multiple ways.[144] However, the relaxed interpretation is inconsistent with the rest of the fraud provision. A relaxed interpretation of exception to discharge under § 523(a)(2)(A) would "swallow[] up the general rule in subdivision (A)."[145] That is, if a statement regarding the debtor's ownership of any single asset or financial condition in one area qualified as a statement respecting the debtor's financial condition under the statute, then it would severely limit the types of fraudulent statements that prohibit discharge.[146] The next subsection explores this argument in greater depth.

Application of the strict interpretation avoids internal inconsistencies because it is reasonable to have a narrow exception to the fraud exception to discharge. The strict interpretation is clear about what type of statement prohibits discharge, and when discharge is allowed under the exception to the

141 MIKVA & LANE, *supra* note 128, at 24.
142 *See* 2A SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 46:5 (7th ed. 2013).
143 *See id.*
144 *See generally* 11 U.S.C. § 523(a)(2).
145 Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 503–04 (Bankr. S.D.N.Y. 1999).
146 *See id.* 230 B.R. 492.

fraud exception.[147] Unlike the relaxed interpretation, it creates no conflict or confusion with the rest of the statute.

3. Avoidance of Redundancy

Another applicable canon is that a statute should be interpreted so as to avoid redundancy or superfluity.[148] This canon, also known as the "each word given effect" canon,[149] holds that "[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant."[150] The idea behind this canon is that Congress intentionally phrased the statute so that every word serves a purpose.[151]

As briefly discussed in the previous subsection, this canon applies to the exception to the fraud provision.[152] Interpreting the fraud provision in accordance with the relaxed construction of "statement respecting the debtor's . . . financial condition," would render the entire exception to discharge redundant. By giving the term such an expansive definition, "virtually every statement by a debtor that induces the delivery of goods or services on credit relates to his ability to pay", and would qualify for the exception to the fraud provision.[153] In keeping with the canon, the phrase must not be interpreted so as to make the statutory text superfluous; thus, the relaxed interpretation is inappropriate. The strict interpretation has no such problem with the canon against redundancy.

The petition for certiorari in *Bandi* advocated for the relaxed interpretation and indirectly invoked the canon against surplusage on other grounds.[154] The petition argued that the statute "makes the inquiry turn not on whether a debtor falsely represented the debtor's 'financial condition,' but rather on whether the debtor made a false 'statement respecting' his or her 'financial condition.'"[155] The petition did not expand on this point, but seemed to suggest that there is a

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147 *See* Bandi v. Becnel (*In re* Bandi), 683 F.3d 671 (5th Cir. 2012).

148 *See* United States v. Menasche, 348 U.S. 528, 538–39 (1955) (citing Montclair v. Ramsdell, 107 U.S. 147, 152 (1883)).

149 2A SUTHERLAND, *supra* note 142, § 46:6.

150 Hibbs v. Winn, 542 U.S. 88, 101 (2004). This canon has been referred to as "one of the most basic interpretive canons." Corley v. United States, 556 U.S. 303, 314 (2009).

151 *See Montclair*, 107 U.S. at 152.

152 *See* 11 U.S.C. § 523(a)(2)(A) (2012).

153 Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 504 (Bankr. S.D.N.Y. 1999).

154 *See* Petition for Writ of Certiorari at 3, Bandi v. Becnel (*In re* Bandi), 683 F.3d 671 (5th Cir. 2012) (No. 12-424).

155 *Id.*

difference between a debtor falsely representing his financial condition and a debtor making a false statement respecting his financial condition.[156] The term should not be read as the former, because the words "statement respecting" would become superfluous.

Although the brief raised a novel argument, it was a contrived one. It failed to discuss how "financial condition" and "statement respecting . . . the debtor's financial condition" differ. Black's Law Dictionary defines a statement in the context of evidence as "[a] verbal assertion or nonverbal conduct intended as an assertion."[157] It also defines false statement as "[a]n untrue statement knowingly made with the intent to mislead."[158] Using these definitions, a debtor making a false statement respecting his financial condition is making an untrue assertion intended to mislead. A debtor that misrepresents his financial condition has made a false assertion with the intent to deceive.[159] Although the two phrases are worded differently, this variation in language has no effect—they mean exactly the same thing. There is no risk of statutory language being redundant.

The above canons of construction show why the strict interpretation is appropriate. The next section examines legislative intent and history, two classic tools of statutory interpretation.[160] They are analyzed concurrently because of their close relationship.[161] Like canons of construction, the use of legislative intent and history in statutory interpretation is subject to some controversy.[162] Despite disagreement by some courts over their use, both legislative intent and legislative history provide clear support for the strict interpretation of the statute.

D. Legislative Intent and History

As with the canons of construction, there is some controversy surrounding the use of legislative intent and legislative history in statutory interpretation.[163] Many courts agree that "[t]he cardinal rule of statutory construction is to

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156 *See id.*

157 BLACK'S LAW DICTIONARY, *supra* note 91, at 1539 (the first definition for statement).

158 *Id.*

159 *See id.*

160 *See* 73 AM. JUR. 2D, *supra* note 84, § 67.

161 *See generally id.*

162 *See generally* Frank B. Cross, *The Significance of Statutory Interpretive Methodologies*, 82 NOTRE DAME L. REV. 1971 (2007); Lawrence M. Solan, *Private Language, Public Laws: The Central Role of Legislative Intent in Statutory Interpretation*, 93 GEO. L.J. 427 (2005).

163 SOLAN, *supra* note 85, at 82–83.

effectuate legislative intent with all rules of construction being aides to that end."[164] Still, some critics have argued that what the legislature wrote is more important than what it may have intended.[165] Nevertheless, the intent of Congress at the time a statute was passed remains a longstanding tool of statutory interpretation.[166] In using this tool, courts consider what the legislature intended to achieve by enacting the statute.[167] In bankruptcy cases, however, the Supreme Court has minimized the importance of legislative history, relying on plain meaning and other textual tools instead.[168] In the present case, analysis of the legislative history of the statute provides additional evidence that Congress intended the strict interpretation.

Legislative intent may be determined through a number of methods. Often, it is established by scrutinizing the legislative history of the statute.[169] As one court put it, "[t]o determine legislative intent, a court construing a statute must look to the apparent statutory purpose as disclosed by its language in light of its legislative history."[170] Because legislative history and intent are closely intertwined, they will be discussed together in this section.

To determine legislative intent, courts may rely on legislative history.[171] Proponents of this tool of statutory interpretation posit that "[legislative] intent can often be inferred, at least in part, from the circumstances surrounding the statute's enactment,"[172] and that statutory language is best understood in context.[173] Some forms of legislative history are considered more useful than others in determining legislative intent.[174] For instance, committee reports and

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164 73 AM. JUR. 2D, *supra* note 84, § 60.

165 SOLAN, *supra* note 85, at 82; *see also* Conroy v. Aniskoff, 507 U.S. 511, 519 (Scalia, J., concurring) ("We are governed by laws, not by the intentions of legislators.").

166 "In construing a statute, a court's paramount concern is the legislative intent in its enactment, and the court determines this intent by reading undefined statutory language according to the rules of grammar and common usage." 73 AM. JUR. 2D, *supra* note 84, § 67.

167 MIKVA & LANE, *supra* note 128, at 7–8. "Courts often use *intent* unanalytically and interchangeably with *purpose* to refer to a source of statutory meaning (the intent of the legislature, the purpose of the legislature) outside of the language of the statute at issue in the litigation." *Id.* at 8 (alteration in original).

168 *See, e.g.*, Lamie v. U.S. Trustee, 520 U.S. 526, 536 (2004).

169 *See* Rogers v. Frito-Lay, Inc., 611 F.2d 1074, 1078–79 (5th Cir. 1980); 2A SUTHERLAND, *supra* note 142, § 45:6.

170 Appeal of Coastal Materials Corp., 534 A.2d 398, 400 (N.H. 1987) (citing State v. Amato, 348 A.2d 339, 340 (N.H. 1975)).

171 *See* SOLAN, *supra* note 85, at 82. Legislative history is comprised of elements such as "background information about circumstances which led to the enactment of a statute, events surrounding enactment, and developments pertinent to subsequent operation." 2A SUTHERLAND, *supra* note 142, § 48:1.

172 SOLAN, *supra* note 85, at 84.

173 *Id.* at 87.

174 MANNING & STEPHENSON, *supra* note 67, at 191.

statements by a bill's sponsors are given more weight than statements in floor debates, or by rank and file members of Congress.[175] This section lays out the evolution of the law and the circumstances in which the wording of the fraud and the false written statement provisions were adopted.

As discussed in Part I, the precursor to the fraud provision, which originated in the 1898 Bankruptcy Act, prohibited debtors from discharging debts "created by . . . fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."[176] Also, a debtor was not permitted to discharge debts that were "judgments in actions for frauds, or obtaining property by false pretenses or false representations."[177] The precursor to the false written statement provision first appeared in the 1903 legislation, which prevented discharge when a debtor "obtained property on credit from any person upon a materially false statement in writing made to such person for the purpose of obtaining such property on credit."[178] With these provisions, "as of 1903, if a debtor had obtained property on credit through the use of an oral misrepresentation, that particular debt would be excepted from discharge; if a debtor had obtained property on credit through the use of a written misrepresentation, none of the debtor's debts could be discharged."[179]

As previously noted, exceptions to discharge in the 1898 statute were exceedingly liberal.[180] The presence of these provisions in the early versions of the Code indicates that Congress has long intended to exclude debts obtained by fraud from discharge in bankruptcy.

In 1960, Congress modified the precursor to the false written statement provision in response to "the abusive practices of certain commercial creditors who 'frequently condoned, or even encouraged, [would-be debtors'] issuance of statements omitting debts with the deliberate intention of obtaining a false agreement for use in the event that the borrower subsequently goes into bankruptcy.'"[181] The statutory language was altered to combine the precursors

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175 *Id.*

176 Bankruptcy Act of 1898, Pub. L. No. 696, § 17, 30 Stat. 544, 550–51 (superseded by 11 U.S.C. § 523(a) (2012)).

177 *Id.* at 550.

178 Act of Feb. 5, 1903, Pub. L. No. 57-62, ch. 487, sec. 4, § 14(b), 32 Stat. 797, 797–98 (repealed 1978) (amending Bankruptcy Act of 1898).

179 Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 708 (10th Cir. 2005).

180 Tabb, *supra* note 30.

181 *In re Joelson*, 427 F.3d at 708 (quoting S. REP. No. 1688, at 2–3 (1960); H.R. REP. No. 1111, at 2–3 (1959)).

to the fraud provision and the false written statement provision.[182] The amended language "did not explicitly allow the discharge of debts incurred based on oral misrepresentations going to financial condition."[183]

The present wording of the fraud provision and the false written statement provision first appeared as part of the Bankruptcy Reform Act of 1978.[184] Representative Don Edwards, a sponsor of the new law, suggested that "financial condition" be given its ordinary meaning in the statute.[185] In the House report from September 28, 1978, Representative Edwards stated that a debt "obtained by a false financial statement within the terms of [§] 523(a)(2) is nondischargeable."[186] Numerous courts have interpreted this statement by the bill's sponsor as weighing in favor of the strict interpretation.[187]

As previously discussed in this Comment, the Fourth Circuit failed to cite a source when it claimed that the legislative history of the fraud provision and the false written statement provision supported the relaxed interpretation.[188] Taking note of this discrepancy, other courts have examined the congressional record and found that instead of supporting the relaxed approach, legislative history tends to favor the strict interpretation:

> [B]ased on Representative Edwards and Senator DeConcini's comments in the House Report, it seems more plausible that Congress intended application of § 523(a)(2)(B) to be limited to "the so-called false financial statement." While a financial statement under § 523(a)(2)(B) may not require the formalities of an audited balance sheet or income statement, nothing in the legislative history indicates that § 523(a)(2)(B) should be expanded beyond statements about a debtor's net worth or overall earning capacity.[189]

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[182] Act of July 12, 1960, Pub L. No. 86-621, sec. 2, §17(a), 74 Stat. 408, 409 (repealed 1978) (amending Bankruptcy Act of 1898).

[183] *In re Joelson*, 427 F.3d at 708 (citation omitted).

[184] Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549, 2590 (codified at 11 U.S.C. § 523 (2012)).

[185] *See* 124 CONG. REC. 32,399 (1978).

[186] *Id.*

[187] *See* Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 502 (Bankr. S.D.N.Y. 1999).

[188] *See* Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1060–61 (4th Cir. 1984).

[189] Jokay Co. v. Mercado (*In re* Mercado), 144 B.R. 879, 883 (Bankr. C.D. Cal. 1992). These are the statements to which the court is referring:

> Subparagraph (B) pertains to the so-called false financial statement. In order for the debt to be nondischargeable, the creditor must prove that the debt was obtained by the use of a statement in writing (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable for obtaining money, property, services, or

In addition to the legislature's statements, the Supreme Court has expressed doubt "that Congress, in fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud."[190] While not conclusive of what the legislature actually intended, it is evidence that the Court understood the intent of the legislature to be to protect creditors from dishonest and fraudulent debtors.

Legislative intent and history also have a close connection with public policy. When Congress passes a statute, it does so to further some policy. In the next section, an analysis of the public policy behind the fraud exception to discharge shows that adopting the strict interpretation would promote better bankruptcy policy.

E. Public Policy

When a statute is unclear, courts may look to the public policy behind its enactment for guidance.[191] Additionally, when multiple readings are possible, courts may examine the policy consequences of the different interpretations.[192] While the importance of the text itself cannot be downplayed, "the proper course in all cases is to adopt that sense of the words which promotes in the fullest manner the policy of the legislature in the enactment of the law and to avoid a construction which would alter or defeat that policy."[193] Indeed, courts presume that the legislature intended the statute to be construed with regard to the policy of the law.[194] This section first considers the policy arguments for a strict interpretation of the statute. Next, it responds to the alternative arguments advanced by advocates of the relaxed interpretation.

> credit reasonably relied; (iv) that the debtor caused to be made or published with intent to deceive. Section 523(a)(2)(B)(iv) is not intended to change from the present law since [any] statement that the debtor causes to be made or published with the intent to deceive automatically includes a statement that the debtor actually makes or publishes with the intent to deceive. Section 523(a)(2)(B) is explained in the House report. Under section 523(a)(2)(B)(i) a discharge is barred only as to that portion of a loan with respect to which a false financial statement is materially false.

124 CONG. REC. 32,399 (1978).

190 Grogan v. Garner, 498 U.S. 279, 287 (1991).

191 73 AM. JUR. 2D, *supra* note 84, § 68.

192 *Id.*

193 *Id.*

194 *Id.*

1. Policy Arguments for a Strict Interpretation

Since enactment of the first bankruptcy law, it has been an established principle that some debts are nondischargeable.[195] Even the Bankruptcy Act of 1898, which contained liberal provisions for the discharge of debts, did not allow for the discharge of debts obtained through fraud.[196] There has long been a policy of strictly construing exceptions to discharge in bankruptcy.[197] Additionally, the Supreme Court has repeatedly emphasized that the provisions of the Code allowing discharge are meant for honest debtors, stating that "[t]he [Code] has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an 'honest but unfortunate debtor.'"[198]

Public policy favors the strict interpretation of "financial condition" in the fraud exception. This interpretation protects creditors by preventing debtors from discharging debts they acquired through misrepresentation or fraud. Under the relaxed interpretation, "[v]irtually any statement concerning an asset or liability arguably relates to financial condition."[199] As a result, the fraud exception to discharge could easily be avoided and "[t]hese debtors will thereby escape the anti-discharge provisions completely."[200] This would clearly be in opposition to the longstanding policy of not allowing debtors who engage in fraud to discharge their debts through bankruptcy.

Adopting the relaxed interpretation used in the Fourth Circuit would have negative public policy consequences. First, "[i]t is a simple notion of decency that someone who acquires money or property through fraud or deception should not escape liability for his or her wrongdoing."[201] Additionally, dishonest debtors should not be rewarded for their fraudulent misrepresentations, which would occur if they were allowed to discharge their debts obtained through fraud. "The broad interpretation would permit many dishonest debtors to avoid the consequences of oral fraud. The better rule decides cases on their merits, rather than on the construction of an ambiguous,

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195 *See* Sabino, *supra* note 3.

196 *See* Bankruptcy Act of 1898, Pub. L. No. 696, § 17, 30 Stat. 544, 550–51 (repealed 1978) (superseded by 11 U.S.C. § 523(a) (2012)).

197 Household Fin. Corp. v. Danns (*In re* Danns), 558 F.2d 114 (2d Cir. 1977) (citing Gleason v. Thaw, 236 U.S. 558, 562 (1915)).

198 Cohen v. de la Cruz, 523 U.S. 213, 217 (1998) (citing Grogan v. Garner, 498 U.S. 279, 287 (1991)).

199 Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 502 (Bankr. S.D.N.Y. 1999).

200 *Id.*

201 Sabino, *supra* note 3, at 101.

statutory phrase that grants a fresh start without regard to the honesty of the debtor."[202] Potential creditors may hesitate to make loans, knowing that even if they are deceived by potential debtors, it will be difficult to object to discharge. Therefore, if the relaxed interpretation were widely accepted, it would have a chilling effect on lending. Creditors would make less loans, and even honest debtors would not be able to obtain financing as readily. It would be unjust to make honest debtors suffer for the acts of dishonest ones.

The case of *Joelson* provides a clear example of the potential consequences that may result from adoption of the relaxed interpretation of "financial condition."[203] In *Joelson*, the debtor worked as a waitress and entered into a relationship with Cadwell, a retired man, after meeting him at the café where she worked.[204] She convinced him to lend her $54,000 by stating that she needed it to save her house from foreclosure.[205] Joelson promised that her brother would lend her the money soon to repay Cadwell.[206] In addition, she promised collateral for the loan—she claimed to own several houses, a motel, and antique cars in other towns.[207] When Cadwell asked to see these properties, she took him to two residences, a motel, and a storage facility, representing that she owned them when in actuality she did not.[208] As a result of her misrepresentations,[209] Cadwell agreed to the loan and mortgaged his home to secure the money.[210] Joelson failed to repay the money, claiming that it had been a gift from a former lover, and subsequently filed for bankruptcy.[211] Cadwell then sought to prevent discharge under the fraud provision.[212] As previously noted in this Comment, the Tenth Circuit adopted the strict interpretation and prevented Joelson from discharging her debt to Cadwell.[213]

To demonstrate the negative policy implications that result from the relaxed interpretation of the phrase "statement respecting the debtor's . . . financial condition," consider the outcome had the court followed the Fourth Circuit's

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202 *In re Alicea*, 230 B.R. at 504.

203 *See generally* Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700 (10th Cir. 2005).

204 *Id.* at 703.

205 *Id.*

206 *Id.*

207 *Id.*

208 *Id.*

209 Joelson also lied about her identity, claiming that she was the "Jolene Joelson" in which one of the properties was titled. *Id.*

210 *Id.*

211 *Id.*

212 *Id.* at 704.

213 *Id.* at 714–15.

reasoning in *Van Steinburg*.[214] Under that interpretation, the debtor's statement that she owned certain residential properties and antique cars qualifies as a statement respecting her financial condition, and the exception to the fraud exception would apply.[215] Joelson would be permitted to discharge the debt to Cadwell. Cadwell, a retiree, would likely struggle to make payments on his new mortgage and his home might be foreclosed upon. Joelson, who had clearly lied about owning the properties to scam Cadwell, would walk away with no obligation to him, free to target another elderly person. It hardly seems appropriate to make Cadwell suffer for Joelson's acts of fraud. While he certainly should have been more diligent—it would have been simple for him to check whether Joelson actually owned the properties she claimed—the lapse is not commensurate with such a punishment. As a result of Joelson's deliberate false representations, Cadwell would have lost over $50,000 with little to no hope of restitution.[216]

The above case raises an important issue: the necessity for creditors to perform due diligence. Congress is not responsible for protecting creditors from dishonest debtors; rather, creditors have an obligation to use due diligence to protect their own financial interests. In *Joelson*, Cadwell neglected to do anything to confirm the debtor's allegations that she owned multiple cars and residences.[217] The purpose of the fraud exception is not to protect the lazy creditor.[218] It is difficult to find a way to protect diligent creditors without overly aiding those who fail to do due diligence. This issue is discussed further in the next subsection.

Permitting debtors who engage in fraud or misrepresentation to discharge the resulting debts in bankruptcy would certainly be displeasing to creditors. If the relaxed interpretation were the law, creditors might wish to strengthen or create other restrictions on discharge, and might lobby the government to make such changes. Congress could create more exceptions to discharge. Debtors who do not engage in fraud or misrepresentation might therefore find it more difficult to discharge other types of debts. It would be unfair to cause honest

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214 Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1060–61 (4th Cir. 1984).

215 *Id.* 744 F.2d 1060.

216 *See generally* 11 U.S.C. § 523(a)(2)(A) (2012). Even if the court had adopted the relaxed interpretation, Cadwell may not have been completely out of luck. He may have been able to prevail by having the case dismissed under § 707(b)(3) by arguing that Joelson filed for bankruptcy in bad faith. *Id.* § 707(b)(3).

217 *In re Joelson*, 427 F.3d at 703.

218 Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 674 (2012) (citing Tummel & Carroll v. Quinlivan (*In re* Quinlivan), 434 F.3d 314, 318–19 (5th Cir.2005)).

debtors to suffer for the acts of dishonest ones, who are permitted to walk away freely.

2. Counterarguments

Although there are public policy rationales that support the strict interpretation, there are some important counterarguments that undermine these views.[219] The petition for certiorari in *Bandi* stated that "the Fifth Circuit's ruling is at odds with the fundamental policy of the [Code]," although it does not elaborate.[220] Proponents of the relaxed interpretation advance several policy arguments that they claim support their position.[221] This subsection acknowledges and addresses these counterarguments to demonstrate that while they present some valid points, they do not warrant an adoption of the relaxed interpretation.

First, advocates of the relaxed interpretation argue that it is "reasonable to require creditors to perform due diligence to ensure that the debtor's statements that induce the creditor to lend the debtor money, property, or services are true."[222] They claim that without this requirement, creditors could avoid investigating the debtor's representations yet remain confident that they will get their money back when the misrepresenting debtor files for bankruptcy.[223] It may be Congress's policy to avoid protecting those who fail to use due diligence to protect their assets. If this is the case, then adopting the strict interpretation would be contrary to Congress's policy by shielding negligent creditors from the consequences of their carelessness.

While it is true that creditors have a responsibility to perform due diligence, it seems inappropriate to blame creditors for being taken advantage of by unscrupulous debtors. In some cases involving the interpretation of the fraud provision, the creditor is an individual—often a friend or associate of the debtor—who will suffer serious financial harm if unable to recoup his or her loan.[224] It is unnecessarily harsh to leave these creditors to suffer for the malfeasance of the debtor because they trusted the debtor and did not

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219 Radmall, *supra* note 15, at 853.

220 Petition for Writ of Certiorari at 3, Bandi v. Becnel (*In re* Bandi), 683 F.3d 671 (5th Cir. 2012) (No. 12-424).

221 *E.g.*, Radmall, *supra* note 15, at 853.

222 *Id.*

223 *Id.*

224 *See, e.g.*, Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 703 (10th Cir. 2005); Norcross v. Ransford (*In re* Ransford), 202 B.R. 1, 2–3 (Bankr. D. Mass. 1996).

meticulously investigate the truth of the statement made concerning the debtor's financial condition. Even when this is not the case, the failure of a creditor to perform due diligence does not justify the actions of the debtor who commits fraud. The notion that Congress would put a higher importance on the policy of allowing negligent creditors to suffer the consequences of their lack of diligence than on preventing and punishing individuals who commit fraud seems incongruous.

Another policy argument frequently put forth in support of the relaxed interpretation is the need to protect debtors from unscrupulous creditors.[225] As noted in Section D above, Congress specifically addressed this issue in modifications to the Code in 1960 and 1978.[226] Nevertheless, there are unscrupulous creditors who would use the fraud provision to prevent debtors from discharging debts that should be an exception to the exception. Although this Comment focuses on debtor misconduct, it is not just debtors who engage in misconduct. In fact, unscrupulous creditors are not uncommon in bankruptcy.[227] For example, courts have historically had a problem with credit card companies in this regard.[228]

Congress is aware of the problem of unscrupulous creditors—it has been aware of the issue since at least 1960.[229] However, it has failed to take any further action amending the fraud or false written statement provisions to protect debtors from unscrupulous creditors. This failure to act may indicate that Congress does not believe dishonest creditors seeking prevention of debtors' discharge under the fraud or the false written statement provisions are a significant problem. Nevertheless, the potential for deceitful creditors does not warrant the adoption of the relaxed interpretation, a standard that would permit dishonest debtors to get away with fraud—the cost is too high.

Another issue with the strict interpretation of the statute, which requires a statement that paints a complete picture of the debtor's financial health, is the potential for litigation. Under the relaxed interpretation, more statements

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225 Radmall, *supra* note 15, at 854.

226 *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2590 (codified at 11 U.S.C. § 523 (2012)); Act of July 12, 1960, Pub L. No. 86-621, sec. 2, §17(a), 74 Stat. 408, 409 (repealed 1978) (amending Bankruptcy Act of 1898).

227 *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 168–69 (2008).

228 Craig A. Bruens, Note, *Melting the Plastic Theories: Advocating the Common Law of Fraud in Credit Card Non-dischargeability Actions Under 11 U.S.C. § 523(a)(2)(A)*, 50 VAND. L. REV. 1257, 1260 (1997).

229 *See generally* Act of July 12, 1960, Pub L. No. 86-621, sec. 2, §17(a), 74 Stat. 408, 409 (repealed 1978) (amending Bankruptcy Act of 1898).

would qualify for the exception to the fraud exception.[230] Conversely, fewer statements would qualify under the strict interpretation. This means that more creditors would file suit against debtors who attempt to discharge their debts through bankruptcy, alleging that discharge should be denied under the fraud exception. Thus, the strict interpretation would allow more creditors to base litigation on oral statements. This additional litigation could prove costly to the courts, and may be analogous to the situation that led to the Statute of Frauds in contract law.[231] Because it is costly for courts to resolve he-said-she-said disputes, legislatures enacted a rule to prevent these disputes from taking up time in the judicial system.[232] Providing creditors with more opportunities to contest debtors' discharge would impose similar costs. As a result, this litigation would consist of one party's word against the other's. The creditor would claim the debtor only talked about one thing and the debtor would deny it. As a result, courts may spend more time on evidentiary issues than other pressing bankruptcy matters.

The policy behind the fraud exception to discharge is to protect creditors by preventing dishonest debtors from discharging debts obtained through fraud.[233] Congress likely enacted multiple exceptions to discharge because it viewed the policy of preventing discharge in certain situations as more important than avoiding messy litigation. Dealing with evidentiary issues in cases brought under the fraud provision is just a side effect of preventing debtors from discharging certain debts that Congress decided should be nondischargeable.

Another policy objective promoted by supporters of the relaxed interpretation is the importance of the fresh start for debtors.[234] While this policy is important, the Supreme Court has emphasized that the fresh start was intended for honest debtors, not debtors who engaged in fraud.[235] Adopting the strict interpretation will not take away the promise of the fresh start for honest debtors. In fact, reserving the promise of a fresh start only for honest debtors may prevent some dishonest individuals from acting fraudulently, since they

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230 Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 502 (Bankr. S.D.N.Y. 1999).

231 *See* 9 RICHARD A. LORD, WILLISTON ON CONTRACTS § 21:1 (4th ed. 2012).

232 *Id.*

233 *See supra* Part II.E.

234 Radmall, *supra* note 15, at 853.

235 Grogan v. Garner, 498 U.S. 279, 286–87 (1991) (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("But in the same breath that we have invoked this 'fresh start' policy, we have been careful to explain that the Act limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.'").

would know that their fraudulent debts could not be discharged through bankruptcy.

CONCLUSION

The correct interpretation of "statement respecting the debtor's . . . financial condition" is that the phrase requires a statement about the debtor's overall financial health. This finding is supported by multiple statutory construction and public policy considerations.[236] Recall the hypothetical from the Introduction about debtor Damien obtaining funds from Creditor Co. through misrepresentation, and then attempting to shed the debt through bankruptcy.[237] While this example is overly simplified, it demonstrates the effects of the different interpretations of "respecting the debtor's . . . financial condition" in the fraud and false written statement provisions of § 523(a)(2).[238]

The Fifth Circuit's recent opinion in *Bandi* renewed the circuit split on the proper interpretation of this ambiguous phrase.[239] Each circuit court that has encountered the issue, save the Fourth and the Second Circuits, has either definitively expressed or tended to support the strict interpretation.[240] While the Supreme Court has denied the petition for certiorari in *Bandi*, it may still choose to deal with the issue in the future. Because this is a significant problem, however, it is not optimal to just wait and see if the Court will decide a case on this issue. A prompt resolution may be accomplished through Congressional action.

After conducting statutory interpretation on the phrase "a statement respecting the debtor's . . . financial condition" in the fraud and false written statement provisions, it seems clear that the strict interpretation espoused by the Tenth and Fifth Circuits is superior. The text and structure of the statute support the strict interpretation. In addition, certain canons of construction also favor the strict construction.

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236 *See supra* Part II.

237 *See supra* Introduction.

238 *See generally* 11 U.S.C. § 523(a)(2) (2012).

239 Bandi v. Becnel (*In re* Bandi), 683 F.3d 671, 677–78 (5th Cir. 2012).

240 *Compare In re Bandi*, 683 F.3d at 677–79, *and* Cadwell v. Joelson (*In re* Joelson), 427 F.3d 700, 707 (10th Cir. 2005), *and* Rose v. Lauer (*In re* Lauer), 371 F.3d 406, 413–14 (8th Cir. 2004), *with* Schneiderman v. Bogdanovich (*In re* Bogdanovich), 292 F.3d 104, 112–13 (2d Cir. 2002), *and* Engler v. Van Steinburg (*In re* Van Steinburg), 744 F.2d 1060, 1061 (4th Cir. 1984).

Congress clearly intended a strict interpretation of "a statement respecting the debtor's . . . financial condition." The legislative history, including the floor statements by sponsors of the Bankruptcy Reform Act of 1978, indicate that Congress intended the fraud provision and the false statement provision to protect victims of fraud by preventing debtors from discharging debts obtained through false pretenses.[241] The public policy motive is even stronger than the statutory interpretation argument. Most courts agree that the strict interpretation yields better public policy results because it prevents dishonest debtors from escaping their obligations.[242]

Resolution of this issue is important because it determines whether the fraud provision can be used to fulfill its purpose of protecting creditors from dishonest debtors. In jurisdictions that adopt the relaxed interpretation, dishonest debtors are rewarded for their fraudulent misrepresentations. Instead of denying the discharge of fraudulently obtained debt, these courts permit "bad" debtors to enjoy a fresh start. Certainly creditors have some duty to practice caution with their investments; nevertheless, it is hardly good public policy to punish them for failing to investigate debtors' claims about assets or liabilities by rewarding a debtor who has engaged in intentional deceit.

Although statutory interpretation demonstrates that the strict interpretation is more in line with the meaning of the Code, Congress's intent, and public policy than the relaxed interpretation, neither interpretation is perfect. Nevertheless, the strict interpretation is superior and should be adopted.

Since the Supreme Court did not grant certiorari in *Bandi*, perhaps the most efficient solution is for Congress to define "financial condition" as the debtor's overall financial health and status in § 101. Adding a definition to § 101 would settle the disagreement regarding the proper statutory interpretation, and allow bankruptcy courts to apply the fraud provision consistently and in accordance with public policy. The new subsection could be inserted as 11 U.S.C. § 101(21C), and would clearly indicate the scope of "financial condition." This Comment proposes the following for the definition:

> (21C) The term "financial condition" means overall financial status, including both assets and liabilities.

The proposed definition makes it clear that "financial condition" does not refer to the ownership of any particular item or items of property. This wording

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241 124 CONG. REC. 32,399 (1978).

242 *See, e.g.*, Weiss v. Alicea (*In re* Alicea), 230 B.R. 492, 504 (Bankr. S.D.N.Y. 1999).

is consistent with the rest of § 101 and gives a simple yet comprehensive explanation of the scope of the term. It also expands on the partial definition of "financial condition" found in the definition of "insolvent."[243] While the definition in § 101(32) indicates that financial condition comprises both assets and liabilities, it does not expressly say whether it refers to the overall financial health of the debtor.[244] Adding this definition to the Code will solve the problem of the circuit split, and prevent dishonest debtors from discharging debts acquired through fraud.[245]

By adding a definition of financial condition to § 101, Congress can dispose of the issue and prevent continued discord among the circuits. Furthermore, the change is so minor, and the public policy arguments in favor of it are so strong, that it seems unlikely there will be significant debate about the measure. While the problem of unscrupulous creditors remains, that would be a separate issue for Congress to deal with.

While the relaxed interpretation used to be widespread, today more and more courts are adopting the strict interpretation in accordance with statutory interpretation of the Code.[246] This shift in opinion represents the beginning of a larger change that promotes fairer bankruptcy policy for both creditors and debtors.

MALLORY VELTEN*

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[243] *See* 11 U.S.C. § 101(32) (2012).

[244] It is possible that Congress intentionally decided to make "financial condition" in the definition of "insolvent" vague. The fraud and false written statement provisions deal with abuse, so Congress may not have wanted to provide a clear standard around which dishonest debtors could skirt. This issue is related to the rules versus standards debate in bankruptcy. *See* Ted Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 581 (2001).

[245] Although this definition helps, it would still be subject to interpretation by the bankruptcy and federal courts. Bankruptcy law is one of the few areas of federal law not administered by an agency. Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384, 384 (2012). As a result, Congress has delegated power to the courts in this field of law in the same way it delegates power to agencies in other areas. *Id.* at 388 & n.12. Because Congress has delegated bankruptcy policy to bankruptcy courts and federal courts, a legislative fix may not be a complete solution *See id.* at 401.

[246] *Compare* Skull Valley Band of Goshute Indians v. Chivers (*In re* Chivers), 275 B.R. 606, 614 (Bankr. D. Utah 2002), *with* American Asset Fin., LLC v. Feldman (*In re* Feldman), 500 B.R. 431 (Bankr. E.D. Pa. 2013), *and* Lamar, Archer & Cofrin, LLP v. Appling (*In re* Appling), 500 B.R. 246 (Bankr. M.D. Ga. 2013).

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