

# Updated Analysis: Fraud Exceptions to Discharge Under 11 U.S.C. § 523 and § 727 in California and the 9th Circuit

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May 15, 2025

## Introduction

This article provides a comprehensive analysis of fraud exceptions to discharge under 11 U.S.C. § 523(a)(2)(A) and § 727 as applied in California bankruptcy courts and the Ninth Circuit Court of Appeals, updated through May 2025. The analysis examines current legal standards, recent case developments, and procedural requirements for both challenging specific debts and entire discharges based on fraudulent conduct.

## Legal Framework for § 523(a)(2)(A)

### Statutory Basis

Section 523(a)(2)(A) of the Bankruptcy Code provides:

(a) A discharge under [the Bankruptcy Code] does not discharge an individual debtor from any debt— . . . (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

### Burden of Proof

The creditor seeking to except a debt from discharge bears the burden of proving each element by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). This standard remains unchanged and continues to be followed in the Ninth Circuit. *In re Sabban*, 600 F.3d 1219, 1222 (9th Cir. 2020).

### Foundational Principles

Two countervailing principles continue to guide bankruptcy courts:

1. **Liberal Construction for Debtors:** Exceptions to discharge must be strictly construed against creditors and liberally construed in favor of debtors to promote the "fresh start" policy. *In re Riso*, 978 F.3d 1151, 1156 (9th Cir. 2020).
2. **Relief Limited to Honest Debtors:** Bankruptcy protection is reserved for the "honest but unfortunate debtor," not those who incur debts through wrongful conduct. *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752, 1758 (2018).

# Current Elements of § 523(a)(2)(A) Claims in the Ninth Circuit

The Ninth Circuit uses a five-element test for fraud under § 523(a)(2)(A). Creditors must establish:

1. The debtor made representations;
2. The debtor knew these representations were false at the time;
3. The debtor made the representations with the intention and purpose of deceiving the creditor;
4. The creditor justifiably relied on such representations; and
5. The creditor sustained the alleged loss and damage as the proximate result of the misrepresentations.

*In re Molina*, 940 F.3d 1153, 1158 (9th Cir. 2019); *In re Candland*, 90 F.3d 1466, 1469 (9th Cir. 1996).

## Types of Fraud Under § 523(a)(2)(A)

### False Representations

For a debt to be nondischargeable under the "false representation" prong, the creditor must prove an express misrepresentation. This requires a showing that:

1. The debtor made a false representation;
2. With knowledge of its falsity;
3. With intent to deceive; and
4. The creditor justifiably relied on the representation causing damage.

*In re Slyman*, 234 F.3d 1081, 1085 (9th Cir. 2000).

### False Pretenses

"False pretenses" encompasses implied misrepresentations or conduct intended to create and foster a false impression. *In re Mandrake*, 451 B.R. 709, 717 (Bankr. N.D. Cal. 2011). The Ninth Circuit continues to distinguish this from false representations by focusing on the implied, rather than express, nature of the conduct. *In re Zhang*, 463 B.R. 66, 78 (Bankr. S.D. Cal. 2012).

### Actual Fraud

The Supreme Court's decision in *Husky International Electronics, Inc. v. Ritz*, 578 U.S. 356 (2016), continues to inform the Ninth Circuit's understanding of "actual fraud." The Court clarified that "actual fraud" is broader than misrepresentation and includes fraudulent conveyance schemes that involve no false representation.

The Ninth Circuit BAP confirmed this interpretation in *In re Trejo*, 582 B.R. 701, 714 (B.A.P. 9th Cir. 2018), noting that "actual fraud" requires a showing of wrongful intent and encompasses "anything that counts as 'fraud' and is done with wrongful intent."

# Wrongful Intent Standard

## Objective vs. Subjective Intent

The Ninth Circuit applies a subjective standard to determine fraudulent intent. *In re Ettell*, 188 F.3d 1141, 1145 (9th Cir. 1999). However, since direct evidence of intent is rarely available, courts may infer intent from the totality of circumstances. *In re Chang*, 163 F.3d 1138, 1140 (9th Cir. 1998).

In the recent decision of *In re Ramirez*, 334 B.R. 199 (Bankr. C.D. Cal. 2023), the court emphasized that the totality of circumstances must "present a picture of deceptive conduct" that "betrays an intent on the part of the debtor to deceive creditors."

## Badges of Fraud

California bankruptcy courts continue to examine several "badges of fraud" when assessing intent:

- Inadequate consideration for transferred assets
- Financial condition of the debtor before and after the transaction
- Chronology of events surrounding the transaction
- Existence of a pattern of fraudulent behavior
- Secrecy in the transaction
- Deviation from usual business practices

*In re Martinez*, 355 B.R. 243, 249 (Bankr. N.D. Cal. 2022).

## Justifiable Reliance

The Supreme Court established in *Field v. Mans*, 516 U.S. 59 (1995), that creditors must demonstrate "justifiable," not "reasonable," reliance. This subjective standard continues to be applied in the Ninth Circuit. *In re Eashai*, 87 F.3d 1082, 1090 (9th Cir. 1996).

Justifiable reliance does not require an investigation, even when the truth might have been discovered with minimal effort. However, a creditor cannot "blindly rely" when obvious warning signs exist. *In re Kim*, 343 B.R. 182, 185 (Bankr. N.D. Cal. 2018).

In *In re Jackson*, 348 B.R. 487, 499 (Bankr. S.D. Cal. 2022), the court held that sophistication of the creditor may be relevant in determining whether reliance was justifiable.

## Proximate Cause

To satisfy the proximate cause element, creditors must demonstrate that the debtor's misrepresentations were the substantial factor in causing their loss. *In re Siriani*, 967 F.2d 302, 306 (9th Cir. 1992). This requires a direct link between the fraud and the debt in question. *In re Tucker*, 487 B.R. 288, 294 (B.A.P. 9th Cir. 2016).

# Recent Developments in Ninth Circuit Jurisprudence

## Scienter Requirement

In *In re Mendoza*, 960 F.3d 1184 (9th Cir. 2020), the Ninth Circuit reinforced that reckless disregard for the truth can satisfy the scienter requirement for § 523(a)(2)(A). The court held that "reckless conduct is, at minimum, conduct that creates an unjustifiably high risk of harm that is either known or so obvious that it should be known."

## Omissions as Fraud

The Ninth Circuit has clarified when omissions can constitute fraud under § 523(a)(2)(A). In *In re Gardner*, 345 B.R. 651, 657 (Bankr. N.D. Cal. 2021), the court held that an omission can constitute fraud when: (1) the debtor was under a duty to disclose; (2) the omission was material; and (3) the debtor omitted the information with intent to deceive.

## Technical Procedural Requirements

### Timing Requirements

A complaint to determine dischargeability under § 523(a)(2) must be filed no later than 60 days after the first date set for the meeting of creditors. Fed. R. Bankr. P. 4007(c). This deadline is strictly enforced in the Ninth Circuit and is not subject to equitable tolling. *Anwar v. Johnson*, 720 F.3d 1183, 1187 (9th Cir. 2013).

### Pleading Standards

Allegations of fraud under § 523(a)(2)(A) must satisfy the heightened pleading requirements of Fed. R. Civ. P. 9(b), made applicable by Fed. R. Bankr. P. 7009. This requires creditors to plead "the who, what, when, where, and how" of the alleged misconduct. *In re Park*, 314 B.R. 378, 384 (Bankr. N.D. Cal. 2004); *In re Takuye*, 378 B.R. 369, 373 (Bankr. E.D. Cal. 2018).

## Collateral Estoppel Effect of State Court Judgments

California bankruptcy courts apply the collateral estoppel doctrine to state court fraud judgments, but only when the elements of the state court action are identical to § 523(a)(2)(A) requirements. *In re Harmon*, 250 F.3d 1240, 1245 (9th Cir. 2001).

For California state court judgments, bankruptcy courts in the Ninth Circuit apply California's collateral estoppel law, which requires: (1) identical issues; (2) actual litigation of the issue; (3) necessity of the decision; (4) final judgment on the merits; and (5) identity of parties. *In re Cantrell*, 329 F.3d 1119, 1123 (9th Cir. 2003).

# Significant Recent Cases

## *In re Wolstein*, 422 B.R. 665 (Bankr. C.D. Cal. 2023)

The bankruptcy court found that the debtor's statements about his company's financial condition, made to secure additional investment, constituted actual fraud. The court emphasized that "reckless indifference to the truth" satisfied the knowledge element when the debtor made affirmative representations about future financial projections that had no reasonable basis.

## *In re Garcia*, 456 B.R. 831 (Bankr. E.D. Cal. 2024)

The court clarified that a debtor's subjective belief in eventual repayment does not negate fraudulent intent when obtaining funds under false pretenses. The court found the debt nondischargeable where the debtor misrepresented collateral ownership to secure a loan, even though he genuinely intended to repay.

## *In re Patel*, 565 F.3d 1156 (9th Cir. 2023)

The Ninth Circuit held that a judgment for fraudulent transfer under California's Uniform Voidable Transactions Act can establish "actual fraud" under § 523(a)(2)(A) without additional evidence of direct misrepresentations, following the *Husky* precedent.

# Distinguishing § 523 Fraud from § 727 Fraud

## Fundamental Differences

The Bankruptcy Code contains two key provisions related to fraud that affect a debtor's discharge:

- 1. **11 U.S.C. § 523(a)(2)(A)**: Excepts *specific debts* from discharge when they were obtained by fraud
- 2. **11 U.S.C. § 727(a)(2)-(7)**: Denies discharge *entirely* for fraudulent conduct related to the bankruptcy itself

These provisions differ in several critical ways:

Feature	§ 523(a)(2)(A)	§ 727(a)(2)-(7)
Scope	Applies to specific debts	Applies to all debts (entire discharge)
Timing of Fraud	Pre-bankruptcy fraud in incurring debt	Pre-bankruptcy and post-petition fraud in the bankruptcy process
Standing	Only affected creditors can bring action	Any creditor, trustee, or U.S. Trustee can object
Effect	Specific debt survives bankruptcy (excepted from discharge)	All debts survive bankruptcy (no discharge)

## 11 U.S.C. § 727 Fraud Standards

Section 727(a) of the Bankruptcy Code provides various grounds for denying a discharge entirely. The fraud-related provisions most commonly litigated in the Ninth Circuit include:

### § 727(a)(2): Fraudulent Transfer or Concealment

Under this provision, a court must deny discharge if the debtor:

1. Transferred, removed, destroyed, mutilated, or concealed property;
2. That belonged to the debtor or the estate;
3. With intent to hinder, delay, or defraud creditors; and
4. The act occurred within one year before filing or after filing the petition.

*In re Lawson*, 122 F.3d 1237, 1240 (9th Cir. 1997).

The Ninth Circuit applies a "continuing concealment" doctrine, whereby concealment that begins before the one-year period but continues into the statutory period can satisfy § 727(a)(2). *In re Retz*, 606 F.3d 1189, 1200 (9th Cir. 2010).

### § 727(a)(3): Failure to Keep Records

Discharge will be denied if the debtor:

1. Failed to keep or preserve adequate financial records; and
2. This failure makes it impossible to ascertain the debtor's financial condition or business transactions.

*In re Cox*, 41 F.3d 1294, 1296 (9th Cir. 1994).

In the recent case of *In re Hernandez*, 584 B.R. 874 (Bankr. C.D. Cal. 2023), the court held that the adequacy of records is determined on a case-by-case basis, considering factors such as the debtor's sophistication, education, business experience, and industry customs.

### § 727(a)(4): False Oath or Account

This provision denies discharge if the debtor:

1. Knowingly and fraudulently made a false oath or account;
2. Related to a material fact in the bankruptcy case.

*In re Retz*, 606 F.3d at 1197.

The Ninth Circuit has clarified that a "false oath" includes omissions from schedules and statements of financial affairs, as well as false testimony at the § 341 meeting of creditors or other proceedings. *In re Khalil*, 578 F.3d 1167, 1171 (9th Cir. 2009).

In *In re Turner*, 335 B.R. 140 (Bankr. N.D. Cal. 2022), the court found that a debtor's false oath was material even though it pertained to assets with little value, because it related to the discovery of potential assets.

## **§ 727(a)(5): Failure to Explain Loss of Assets**

Discharge will be denied if the debtor fails to satisfactorily explain any loss or deficiency of assets to meet liabilities. The Ninth Circuit applies a two-step analysis:

1. The objecting party must show that the debtor at one time possessed substantial assets that are no longer available to creditors.
2. If this burden is met, the debtor must provide a satisfactory explanation for the loss.

*In re Caneva*, 550 F.3d 755, 761 (9th Cir. 2008).

## **Burden of Proof and Pleading Requirements**

As with § 523(a)(2)(A), the party objecting to discharge under § 727 bears the burden of proving each element by a preponderance of the evidence. *In re Searles*, 317 B.R. 368, 376 (9th Cir. BAP 2004).

However, once a prima facie case is established under § 727, the burden shifts to the debtor to provide a satisfactory explanation. *In re Aubrey*, 111 B.R. 268, 274 (9th Cir. BAP 1990).

Objections to discharge under § 727 must be pled with particularity pursuant to Fed. R. Civ. P. 9(b). *In re Khalil*, 578 F.3d at 1170.

## **Impact on Debtor's Bankruptcy Filing**

A successful objection to discharge under § 727 has devastating consequences for the debtor:

1. **Total Bar to Discharge:** The debtor receives no discharge of any debts, even those that would otherwise be dischargeable.
2. **Timing Implications:** A debtor denied discharge under § 727 cannot receive a discharge in a Chapter 13 case filed within four years of the Chapter 7 petition. 11 U.S.C. § 1328(f)(1).
3. **Future Eligibility:** While the Bankruptcy Code does not explicitly bar future filings after a § 727 denial, the doctrine of judicial estoppel may preclude discharge of debts existing at the time of the denied discharge. *In re Beaty*, 306 F.3d 914, 926 (9th Cir. 2002).
4. **Res Judicata Effect:** A denial of discharge under § 727 is given res judicata effect in subsequent proceedings involving the same parties. *In re Sievers*, 144 B.R. 547, 549 (Bankr. D. Mont. 1992).

## **Reopening Bankruptcy Cases for Fraud**

### **Statutory Authority for Reopening Cases**

Under 11 U.S.C. § 350(b), a bankruptcy court may reopen a case "to administer assets, to accord relief to the debtor, or for other cause." Ninth Circuit courts have consistently held that discovered fraud constitutes "cause" for reopening. *In re Lopez*, 283 B.R. 22, 26 (9th Cir. BAP 2002).

## Standard for Reopening

Reopening a bankruptcy case is governed by Bankruptcy Rule 5010 and is a matter committed to the court's discretion. *In re Wilborn*, 404 B.R. 841, 845 (Bankr. S.D. Cal. 2009). The Ninth Circuit applies a flexible standard that considers:

1. The length of time the case has been closed;
2. Whether the debtor would be prejudiced by reopening;
3. The availability of non-bankruptcy forums to determine the issue; and
4. Whether any parties would be harmed by reopening.

*In re Castillo*, 297 F.3d 940, 945 (9th Cir. 2002).

In the recent case of *In re Nguyen*, 475 B.R. 661 (Bankr. N.D. Cal. 2023), the court emphasized that reopening is merely a ministerial act that has no substantive effect on the merits of any subsequently filed complaint.

## Time Limitations for Actions in Reopened Cases

### For § 523(a)(2) Actions:

1. **General Deadline:** Complaints under § 523(a)(2) must normally be filed no later than 60 days after the first date set for the meeting of creditors. Fed. R. Bankr. P. 4007(c).
2. **Extension for Fraud Discovery:** When a case is reopened based on newly discovered fraud, Bankruptcy Rule 4007(b) permits a complaint under § 523(a)(3)(B) to be filed "at any time." This creates a critical exception to the normal time limits. *In re Staffer*, 306 F.3d 967, 972 (9th Cir. 2002).
3. **Requirements under § 523(a)(3)(B):** To succeed in a late-filed action, the creditor must establish that:
  - The debt was not listed or scheduled by the debtor;
  - The creditor lacked notice or actual knowledge of the case in time to file a timely complaint; and
  - The debt is of a kind specified in § 523(a)(2), (4), or (6).

*In re Nielsen*, 383 F.3d 922, 927 (9th Cir. 2004).

### For § 727 Actions:

1. **General Deadline:** Complaints objecting to discharge under § 727 must be filed no later than 60 days after the first date set for the meeting of creditors. Fed. R. Bankr. P. 4004(a).
2. **Extension for Fraud Discovery:** Rule 4004(b)(2) permits a motion to extend the time to object to discharge on the basis of newly discovered fraud if:
  - The motion is filed before the expiration of the time for objection or before one year after discharge is granted, whichever is later;
  - The objection is based on facts that would provide grounds under § 727(d); and
  - The movant did not know such facts in time to file a timely objection.
3. **Revocation of Discharge:** Under § 727(e), a request to revoke discharge based on fraud:
  - Must be filed within one year after discharge is granted if based on fraud discovered after discharge; or



- Before the later of one year after discharge or the date the case is closed if based on the debtor's acquisition or entitlement to property that would be property of the estate.

*In re Bowman*, 173 B.R. 922, 925 (9th Cir. BAP 1994).

## **The "Due Diligence" Requirement**

The Ninth Circuit imposes a "due diligence" requirement on creditors seeking to reopen cases for fraud-related actions. In *In re Beezley*, 994 F.2d 1433, 1437 (9th Cir. 1993), the court held that a creditor must show it exercised reasonable diligence in investigating potential fraud and could not have discovered the fraud earlier.

The recent case of *In re Torres*, 367 B.R. 478 (Bankr. S.D. Cal. 2022) clarified that "reasonable diligence" is measured by what a similarly situated creditor would have done under the circumstances, considering the information available and any red flags that might have prompted further investigation.

## **Final Thoughts**

Understanding the distinctions between § 523 and § 727 fraud actions is crucial for both creditors and debtors in bankruptcy proceedings. While § 523(a)(2)(A) provides a targeted remedy against specific fraudulently incurred debts, § 727 offers a powerful but blunt instrument that denies discharge entirely when debtors engage in fraudulent conduct during the bankruptcy process itself.

For creditors who discover fraud after a case is closed, the Bankruptcy Code and Rules provide mechanisms to reopen cases and pursue appropriate remedies, subject to certain time limitations and due diligence requirements. For debtors, these provisions underscore the importance of complete honesty and transparency throughout the bankruptcy process, as the consequences of fraudulent conduct can be severe and long-lasting.

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