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John P. Hunt

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PRIORITY TREATMENT OF FRAUD CLAIMS IN BANKRUPTCY

John Patrick Hunt[*]

"For this by nature is equitable, that no one be made richer by another's loss." [**]

ABSTRACT

This Article defends the priority treatment of fraud claims in bankruptcy. The Article offers a new normative defense of priority, arguing that priority for fraud claims should be rooted not merely in the involuntariness of the victim's transfer but in the wrongfulness of fraud itself—specifically, the principle that no party, including innocent creditors, should profit from intentional deception at the expense of the victim.

The Article also challenges the main existing vehicle for fraud priority: constructive trust and its associated tracing requirement. Under current law, fraud victims can achieve priority only if they can identify, or trace, specific assets acquired through fraud, a condition that can fail to reflect whether the bankruptcy estate has actually been enriched. The tracing requirement is thus in tension with the prevailing justification for constructive trust, namely combating unjust enrichment.

The Article critiques the tracing requirement as an inapt tool for combating unjust enrichment. It revisits the once-popular "swollen-assets" theory, which presumes continued enrichment based on a showing of initial enrichment and thus did not require tracing in the current sense. The Article proposes either statutory priority for fraud claims or expansion of constructive-trust doctrine, potentially through revival of the swollen-asset theory.

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* Martin Luther King, Jr. Professor of Law, University of California, Davis School of Law (King Hall), jphunt@ucdavis.edu. Thanks to Jacob Finnell for excellent research assistance. Thanks to King Hall Dean Jessica Berg and Senior Associate Dean for Academic Affairs Donna Shestowsky for financial support. Thanks to Ralph Brubaker, Katherine Florey, Ted Janger, and Robert Miller for helpful comments.

** DIG. 50.17.206 (Pomponius, Ex Variis Lectionibus 9) (quoted in translation in JOHN P. DAWSON, UNJUST ENRICHMENT: A COMPARATIVE ANALYSIS 3 (1951)).

The Article calls for a shift in doctrinal focus from tracing the proceeds of fraud to measuring and remedying unjust enrichment, thereby aligning bankruptcy outcomes more closely with foundational principles of fairness and restitution.

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INTRODUCTION

A general contractor contracted with a limited liability company subcontractor to work on a condominium project.[1] As a court later found, the subcontractor persuaded the contractor to advance funds not required under the contract, assuring the contractor that the subcontractor would use the funds to buy materials for the contractor's job before the price of the materials went up.[2] But the subcontractor had no intention of doing so. Instead, it planned to use the funds to finance payroll and work on other jobs.[3] And that is exactly what it did.[4]

The contractor sued for unjust enrichment and unfair trade practices based on the fraudulent conduct in state court and won a judgment against both the limited liability company subcontractor and an individual who was the subcontractor's manager and controlling member.[5] The individual filed for bankruptcy.[6] The debt arising out of the fraud was nondischargeable.[7] But whether the contractor will enjoy priority over the subcontractor's general creditors likely would depend on whether the contractor can "trace" the funds to the subcontractor's (and thus the bankruptcy trustee's) possession, using an arcane set of much-criticized tracing rules.[8]

If the contractor can trace the funds, in most jurisdictions, it likely can impose a constructive trust on the traced assets and remove them from the bankruptcy estate, achieving priority over general unsecured creditors.[9] If the contractor cannot trace the funds, it will be a general creditor like all the others.[10]

The question of priority for fraud claims in bankruptcy has divided scholars and courts.[11] Criticisms have been leveled at both the possibility of priority[12]

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1 Pointe Residential Builders BH, LLC v. TMP Constr. Grp., Inc, FSTCV186037047, 2020 WL 1231575, at *1 (Conn. Super. Ct. Feb. 18, 2020).

2 *See id.*

3 *Id.*

4 *See id.*

5 *See id.* at *2–3.

6 *See* Voluntary Petition at 1, Pointe Residential Builders BH, LLC v. Paige (*In re* Paige), No. 24-799 (D. Conn. Oct. 31, 2022).

7 *See* Pointe Residential Builders BH, LLC v. Paige (*In re* Paige), No. 24-799, 2025 WL 99753, at *8 (D. Conn. Jan. 15, 2025). In the decision in question, the district court upheld the bankruptcy court's judgment of nondischargeability based on collateral estoppel; the parties had fully and fairly litigated the relevant issues in state court. *Id.* at *6–8.

8 *See* discussion *infra* Parts I.B, IV.A.

9 *See* discussion *infra* Part I.B.

10 *See* discussion *infra* Parts I.A, B.

11 *See* discussion *infra* Parts I, II.

12 *See* discussion *infra* Parts II.B, II.D.

and at the tracing rules upon which priority effectively depends.[13] This Article defends the availability of priority against its critics but joins the criticism of the tracing rules.

On the first point, this Article argues that where denying priority to a fraud victim would cause the general creditors to be enriched at the victim's expense, priority is justified. The traditional justification for imposing a constructive trust in this setting is that the claimant has involuntarily enriched the debtor. The Article offers an alternative justification based on the principle that one should not profit from wrongdoing at the expense of the victim.[14] It therefore focuses on the wrongfulness of deception, rather than (or in addition to) the involuntariness of the transfer. On the second point, this Article argues that where a perpetrator has acquired property from a victim by fraud, tracing rules are a poor way of answering the essential question: whether the estate is still enriched as a result of the fraud when value is assessed for distribution.[15]

More robust priority treatment for fraud victims could be achieved through applying more generous tracing rules or through enacting statutory priority for fraud victims.[16] The latter is probably the best solution, but given the difficulty of enacting reform through Congress, courts should consider the former approach.[17]

The prototypical debtor considered in this Article is the business-entity debtor. Although the Article's argument does not explicitly rely on the type of debtor and thus applies to individual debtors as well, priority for fraud claims is arguably less of an issue in the individual context. This is because of the large

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13 *See* discussion *infra* Part IV.

14 *See* discussion *infra* Part III.

15 *See* discussion *infra* Part IV. The Article uses the term "distribution" to cover both liquidation and the allocation of rights through a Chapter 11 plan. Although true reorganization plans do not necessarily distribute the debtor's property, such plans have been described as vehicles for distribution of the excess of the entity's going concern value over its liquidation value. *See* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 88 (1991); *see also* Pamela Foohey, *Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities*, 86 ST. JOHN'S L. REV. 32, 34–35 (2012) (citing, *inter alia*, Markell).

16 *See* discussion *infra* Part V.A.

17 *See* discussion *infra* Part V.A.

number of no-asset cases[18] and because nondischargeability is such an important part of bankruptcy law's response to fraud committed by individual debtors.[19]

Part I of the Article surveys the current treatment of fraud claims in bankruptcy and the positive law governing constructive trust, the principal way in which fraud victims can get priority under current law. Part II reviews the scholarly literature relating to priority for fraud victims, which has focused primarily on the role of constructive trust in bankruptcy. Part III defends priority for fraud victims in bankruptcy and argues that fraud claims are meaningfully different, both from other tort claims and from contract claims. Part IV argues that current tracing rules are a poor way of measuring any unjust enrichment from fraud at the time of assessment of value for distribution. Part V considers alternatives for expanding protection of fraud victims in bankruptcy, including expanding constructive trust, statutory priority, and nondischargeability. Part VI addresses objections to expanding priority for fraud claims in bankruptcy.

I. POSITIVE-LAW BACKGROUND

Part I outlines the positive law of fraud claims in bankruptcy. Part I.A describes the nondischargeability of many fraud claims and the absence of statutory priority for such claims. Part I.B addresses how the doctrine of constructive trust operates in bankruptcy. A limited class of fraud claims can achieve priority through application of this doctrine.

A. Treatment of Fraud Claims in the Bankruptcy Code

The Bankruptcy Code (the "Code") currently accords special status to fraud claims by making them nondischargeable in some instances, rather than by granting them statutory priority. As we shall see, however, the non-Code remedy of constructive trust functionally provides a form of priority for some fraud claims.

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18 *See, e.g.*, Kipp Flores Architects, L.L.C. v. Mid-Continent Cas. Co., 852 F.3d 405, 411 (5th Cir. 2017) ("most Chapter 7 cases begin and end as no asset cases") (quoting *In re* Corgiat, 123 B.R. 388, 389 (Bankr. E.D. Cal. 1991)); *Chapter 7 – Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/court-programs/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics (last visited Feb. 27, 2026) ("Most chapter 7 cases involving individual debtors are no asset cases.").

19 *See* discussion *infra* Part I.A.

At least five overlapping provisions of the Code render various debts procured by fraud nondischargeable.[20] These provisions apply to individuals in chapter 11,[21] and certain key provisions apply to individuals in chapter 13.[22]

For business entities, a much smaller set of fraud debts is nondischargeable. In chapter 7 liquidation, business entities do not get a discharge, so nondischargeability does not apply.[23] In chapter 11, by contrast, the discharge for business entities is broad. [24] With exceptions,[25] it covers "any debt that arose before . . . confirmation."[26] The single provision making certain types of business-entity debt nondischargeable, section 1141(d)(6), addresses fraud and fraud-adjacent conduct directed at the government. It covers fraud debts owed to a domestic governmental unit,[27] amounts owed to private parties in qui tam actions in which a private party sues to recover a claim owed to the government,[28] and taxes as to which the debtor made a fraudulent return[29] or that the debtor tried to "evade or defeat."[30]

The Code does not grant fraud claims statutory priority over general unsecured claims.[31] Indeed, many securities fraud claims are subordinated to claims based on the associated security or given the priority of equity if they are based on the sale of common stock.[32]

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[20] *See* 11 U.S.C. § 523(a)(2) ("money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud"); 11 U.S.C. § 523(a)(4) ("fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny"); 11 U.S.C. § 523(a)(6) ("willful or malicious injury by the debtor to another entity or to the property of another entity"); 11 U.S.C. § 523(a)(11) ("fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union"); 11 U.S.C. § 523(a)(19) (judgments, orders, and settlement agreements for securities fraud).

[21] *See* 11 U.S.C § 1141(d)(2).

[22] 11 U.S.C. § 1328(a)(2) (excepting from chapter 13 discharge, among others, claims covered by section 523(a)).

[23] *See* 11 U.S.C. § 727(a)(1) (providing that only individuals receive a discharge in chapter 7).

[24] Individual debtors face the same nondischargeability rules in chapter 11 as in chapter 7. *See* 11 U.S.C. § 1141(d)(2).

[25] For example, an exception covers liquidating plans, see 11 U.S.C. § 1141(d)(3).

[26] 11 U.S.C. § 1141(d)(1)(A).

[27] 11 U.S.C. § 1141(d)(6)(A).

[28] *Id.* (excepting from discharge claims "owed to a person as the result of an action filed under subchapter III of chapter 37 of title 31 or any similar State statute"); *see also* 8 COLLIER ON BANKRUPTCY ¶ 1141.05[1][b][ii] (16th ed. 2025) (clarifying that the referenced provision refers to amounts owed to private parties in *qui tam* actions).

[29] 11 U.S.C. § 1141(d)(6)(B)(i).

[30] 11 U.S.C. § 1141(d)(6)(B)(ii).

[31] *See* 11 U.S.C. §§ 364(c)(1), 506(c), 507(a), 507(b), 726(b) (enumerating priorities and not including fraud claims).

[32] *See* 11 U.S.C. § 510(b).

B. Positive Law of Constructive Trust and Bankruptcy

In most jurisdictions, the doctrine of constructive trust affords priority in bankruptcy to at least some fraud claimants. On constructive trusts generally, the *Restatement (Third) of Restitution and Unjust Enrichment* provides:

> If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant's rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.[33]

Imposition of a constructive trust obligates the trustee to surrender the trust property to the claimant.[34] In bankruptcy, this translates to the claimant's "right to recover the trust property from the bankruptcy trustee."[35]

Acquisition of property by fraud is a classic example of unjust enrichment at the expense of the defrauded party and in violation of its rights.[36] A victim who has been defrauded of money or other property could seek the imposition of a constructive trust to ensure the property's return, provided that the property was identifiable.

In bankruptcy, imposing a constructive trust excludes the affected property from the bankruptcy estate[37] and awards it to the constructive-trust claimant.[38] Although the Code does not contain the words "constructive trust," courts deciding whether to recognize a constructive trust in bankruptcy have analyzed the issue using section 541(d) of the Code,[39] which provides that where the debtor holds equitable but not legal title to property, only the legal title enters

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33 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55(1) (A.L.I. 2011).

34 *Id.* § 55(2).

35 *See* Azhar Chaudhary L. Firm, P.C. v. Ali (*In re* Riverstone Resort, L.L.C.), 122 F.4th 576, 581 (5th Cir. 2024) (quoting Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 436 (5th Cir. 1994)).

36 *See, e.g.*, McMerty v. Herzog, 710 F.2d 429, 431 (8th Cir. 1983) ("[A] constructive trust . . . is imposed to prevent unjust enrichment when property is acquired by fraud or breach of a fiduciary duty."). *See also* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55 cmt. d (A.L.I. 2011); *see* 2 DAN B. DOBBS, LAW OF REMEDIES 6 (2d ed. 1993) (stating that constructive trust and related remedies are "[t]ypically . . . invoked against fiduciaries . . . or against persons who have obtained money by fraud or duress").

37 *See, e.g.*, *In re* Ursa Operating Co., No. 22-1729, 2024 WL 278397, at *2 (3d Cir. Jan. 25, 2024); *In re* Miss. Valley Livestock, Inc., 745 F.3d 299, 305 (7th Cir. 2014); Cadle Co. v. Mangan (*In re* Flanagan), 503 F.3d 171, 180 (2d Cir. 2007); Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 435–36 (5th Cir. 1994); *In re* Green, 662 B.R. 835, 840 (Bankr. D. Conn. 2024); Enhabit, Inc. v. Nautic Partners IX, L.P., C.A. No. 2022-0837-LWW, 2025 WL 1392219, at *7 n.71 (Del. Ch. May 14, 2025).

38 *See, e.g.*, *In re Miss. Valley Livestock*, 745 F.3d at 305.

39 *See, e.g.*, *id.*; *In re* ABC Learning Ctrs. Ltd., 728 F.3d 301, 312 (3d Cir. 2013); Cadle Co. v. Mims (*In re* Moore), 608 F.3d 253, 263 (5th Cir. 2010).

the bankruptcy estate.[40] This approach grounds the exclusion of constructive-trust property from the estate in statutory text.

This treatment of constructive-trust property in bankruptcy effectively gives the constructive-trust claimant's restitutionary claim a priority over other unsecured claims.[41] Thus, as Professor Emily Sherwin has pointed out, the underlying equities attending a constructive-trust claim differ depending on whether the defendant is or is not in bankruptcy or a comparable proceeding.[42]

Outside bankruptcy, the party that loses through imposition of a constructive trust is the party that was unjustly enriched in the first instance. In bankruptcy, the parties who lose because of the imposition of the constructive trust are (or at least can be) other unsecured creditors, rather than the debtor. Assuming that constructive-trust claims typically arise from wrongdoing and that the other creditors generally did not engage in the wrongdoing giving rise to the constructive-trust claim, courts arguably should be more reluctant to recognize constructive trust in the bankruptcy context.[43]

Even so, it appears that most federal appellate courts recognize the possibility of imposing a constructive trust in bankruptcy where the state-law conditions for the remedy are met,[44] although it is common to exercise some

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40 *See* 11 U.S.C. § 541(d).

41 *See, e.g.*, *In re* U.S. Lan Sys. Corp., 235 B.R. 847, 856 (Bankr. E.D. Va. 1998); Milwaukee Cheese Wis. v. Bukowski (*In re* Milwaukee Cheese Wis.), 164 B.R. 297, 305 (Bankr. E.D. Wis. 1993).

42 *See* Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. L. REV. 297, 317 ("In most bankruptcy cases, the parties affected are unsecured creditors, and the constructive trust remedy should apply only when retention of property by the bankruptcy estate would result in an unjust enrichment of competing creditors.").

43 *See id.* at 318–26 (recommending limits on the constructive-trust remedy that courts should observe in bankruptcy).

44 For convenience, the authorities in this footnote are arranged in circuit order. *See* Davis v. Cox, 356 F.3d 76, 84–85 (1st Cir. 2004) (recognizing constructive trust); Ades & Berg Grp. Invs. v. Breeden (*In re* Ades & Berg Gp. Invs.), 550 F.3d 240, 245 (2d Cir. 2008) (recognizing possibility of imposing constructive trust in bankruptcy); *In re* Ursa Operating Co., No. 22-1729, 2024 WL 278397 (3d Cir. Jan. 25, 2024), at *4 (recognizing possibility of constructive trust in Third Circuit); Schrider v. Schlossberg (*In re* Greenbelt Rd. Second Ltd. P'ship.), No. 94-1522, 1994 WL 592766 (4th Cir. Oct. 31, 1994), at *3 (recognizing possibility of imposing constructive trust in bankruptcy in Fourth Circuit); Azhar Chaudhary Law Firm, P.C. v. Ali (*In re* Riverstone Resort, LLC), 122 F.4th 576, 581 (5th Cir. 2024) (assuming constructive trust available in Fifth Circuit); *In re Miss. Valley Livestock*, 745 F.3d at 304–07 (recognizing possibility of imposing constructive trust in bankruptcy in Seventh Circuit); Chiu v. Wong, 16 F.3d 306, 310 (8th Cir. 1994) (recognizing constructive trust in bankruptcy in Eighth Circuit); Mitsui Mfrs. Bank v. Unicom Comput. Corp. (*In re* Unicom Comput. Corp.), 13 F.3d 321, 325 (9th Cir. 1994) (recognizing constructive trust in bankruptcy); Dep't of Energy v. Seneca Oil Co. (*In re* Seneca Oil Co.), 906 F.2d 1445, 1456 (10th Cir. 1990) (affirming finding of "sufficient wrongdoing" for imposition of constructive trust in bankruptcy and remanding for tracing inquiry); Graybill v. Thomas (*In re* Graybill), 806 F. App'x 920, 926 (11th Cir. 2020) (upholding imposition of constructive trust in bankruptcy); Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 273 (D.C. Cir. 1987) (recognizing

degree of extra caution in doing so.[45] It appears that only the Sixth Circuit has actually ruled that a bankruptcy court cannot apply the remedy in the first instance,[46] and that court has subsequently qualified that holding in some respects.[47]

Given that fraud is a principal reason for imposing constructive trust,[48] jurisdictions that permit constructive trust in bankruptcy presumably would allow fraud claimants to make use of the remedy. And courts across the country have recognized that a constructive trust can be imposed on a bankrupt debtor in favor of a fraud claimant, although factual claims of fraud are frequently

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possibility of imposing constructive trust in bankruptcy). For a thorough survey of caselaw as of 2017, see Tristan Axelrod & Fouad Kurdi, *Constructive Trust Claims in Bankruptcy: Breaking Down the Court's Ongoing Failure to Articulate a Reliable Approach*, 2017 NORTON ANN. SURV. OF BANKR. L. 5–12 (2017).

[45] *See In re Miss. Valley Livestock*, 745 F.3d at 305 ("[T]he constructive trust can subvert bankruptcy's distribution scheme if courts lose sight of the fact that it is an extraordinary equitable remedy, to be used sparingly."); *Ades & Berg Grp.*, 550 F.3d at 244–45 (declining to impose constructive trust in bankruptcy) (quoting Superintendent of Ins. v. Ochs (*In re* First Cent. Fin. Corp.), 377 F.3d 209, 218 (2d Cir. 2004), *aff'd*, 777 F. App'x 16 (2d Cir. 2019)) ("the equities of bankruptcy are not the equities of the common law"); Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 436 (5th Cir. 1994) ("Because the constructive trust doctrine can wreak such havoc with the priority system ordained by the Bankruptcy Code, bankruptcy courts are generally reluctant to impose constructive trusts without a substantial reason to do so.") (internal quotation marks omitted); *Schrider*, 1994 WL 592766, at *3 (constructive trusts "not favored" in bankruptcy); *Drabkin*, 810 F.2d at 275 (imposing constructive trust in bankruptcy, though possible, "tends to undercut the statutory scheme"); Torres v. Eastlick (*In re* N. Am. Coin & Currency, Ltd.), 767 F.2d 1573, 1575 (9th Cir. 1985) ("We necessarily act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors"). At least one court has reconciled extra caution around constructive trusts in bankruptcy with the principle that state-law entitlements are to be respected in bankruptcy by stating, "[r]ecognizing different equities in different contexts is not an impermissible transformation of the substantive law." *Ades & Berg Grp.*, 550 F.3d at 245.

[46] *See* XL/Datacomp, Inc. v. Wilson (*In re* Omegas Grp., Inc.), 16 F.3d 1443, 1451 (6th Cir. 1994) (refusing to impose constructive trust on funds based on fraud theory and stating, "[section] 541(d) simply does not permit a claimant in the position of Datacomp to persuade the bankruptcy court to impose the remedy of constructive trust for alleged fraud committed against it by the debtor in the course of their business dealings, and thus to take ahead of all creditors . . ."). The opinion does leave open the possibility that it might be appropriate to recognize in bankruptcy a constructive trust impressed prepetition. *See* XL/Datacomp, Inc. v. Wilson (*In re* Omegas Grp., Inc.), 16 F.3d 1443, 1451 (6th Cir. 1994). After *Omegas Group*, the Sixth Circuit has recognized limits on its bar to constructive trusts in bankruptcy in some circumstances.

[47] *See* McCafferty v. McCafferty (*In re* McCafferty), 96 F.3d 192, 196–99 (6th Cir. 1996) (finding constructive trust in bankruptcy appropriate where property in question was not available for distribution to general creditors and was awarded in part to claimant under prepetition divorce decree); *see also* Kitchen v. Boyd (*In re* Newpower), 233 F.3d 922, 937 (6th Cir. 2000) (lifting automatic stay to permit claimant to proceed with constructive-trust action initiated prepetition to recover proceeds of allegedly stolen funds).

[48] *See, e.g.*, McMerty v. Herzog, 710 F.2d 429, 431 (8th Cir. 1983) ("[A] constructive trust . . . is imposed to prevent unjust enrichment when property is acquired by fraud or breach of a fiduciary duty."); s*ee also* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55 cmt. d (A.L.I. 2011); *see* DOBBS, *supra* note 36, at 6 (stating that constructive trust and related remedies are "[t]ypically . . . invoked against fiduciaries . . . or against persons who have obtained money by fraud or duress").

rejected.[49] Actual imposition of constructive trusts seems to be more common in the context of misappropriation of entrusted assets[50] than in other types of fraud, although cases of the latter type do exist.[51] This may reflect the possibility that it is more difficult to trace property outside the misappropriation context.[52]

Courts also sometimes exclude property the debtor has acquired through fraud from the bankruptcy estate without mentioning constructive trust.[53]

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[49] *See, e.g.*, Azhar Chaudhary Law Firm, P.C., 122 F.4th at 581 (assuming that a constructive trust would be proper to recover funds from an entity controlled by the lawyer who lied about providing legal services if a statute-of-limitations defense did not apply); *Graybill*, 806 F. App'x at 925–26 (upholding imposition of constructive trust in bankruptcy where debtor engaged in "fraudulent" conduct of representing that she had right to sell collateral that she knew was actually subject to secured lender's writ of possession); Wallace v. McFarland (*In re* McFarland), 619 F. App'x 962, 973–74 (11th Cir. 2015) (applying state-law principles and finding constructive trust improper where no fraud or other basis shown); *In re Miss. Valley Livestock*, 745 F.3d at 305 ("property obtained by fraud is not part of the bankrupt's estate") (quoting *In re* Teltronics, Ltd., 649 F.2d 1236, 1239 (7th Cir. 1981)); Superintendent of Ins. v. Ochs (*In re* First Cent. Fin. Corp.), 377 F.3d 209, 216 (2d Cir. 2004), *aff'd*, 777 F. App'x 16 (2d Cir. 2019) ("New York law is clear that a constructive trust is an equitable remedy intended to be 'fraud-rectifying'"); *Chiu*, 16 F.3d at 310 (imposing constructive trust where partner misappropriated partnership property); *Haber Oil*, 12 F.3d at 439–40 (declining to impose constructive trust where claimant failed to meet pleading requirements for fraud); Torres, 767 F.2d at 1576–77 (declining to impose constructive trust on bankrupt debtor where claimant presented insufficient evidence of fraud); Stillwater Liquidating LLC v. Net Five Palm Pointe, LLC (*In re* Stillwater Asset Backed Offshore Fund Ltd.), 16 Civ. 8883, 2018 WL 1610416 at *13 (S.D.N.Y. Mar. 30, 2018) (denying constructive trust where no fraud alleged; remedy is "intended to be fraud-rectifying") (internal quotation marks omitted) (quoting Superintendent of Ins., N.Y. v. Ochs (*In re* First Cent. Fin. Corp.), 377 F.3d 209, 216 (2d Cir. 2004)), *aff'd*, 777 F. App'x 16 (2d Cir. 2019); Detiege v. Rosauer (*In re* Detiege), BAP No. ID-21-1177-GBS, 2022 WL 843374, at *1–2, *4 (B.A.P. 9th Cir. Mar. 22, 2022) (affirming bankruptcy court's imposition of constructive trust based on allegations of actual fraud, misrepresentation, and concealment); Cruse v. Burch (*In re* Shulyn X. Zhang), 562 B.R. 190, 201 (Bankr. E.D. Mo. 2017) (imposing constructive trust on debtor who defrauded buyer of debtor's home); Rajala v. US Bank (*In re* Christenson), 483 B.R. 743, 749–50 (Bankr. D. Kan. 2012) (borrower who defrauded credit card issuer to obtain cash advance held funds advanced in constructive trust); Keybank USA, N.A. v. Lentz (*In re* Guess), Bankr. No. 05-55521-NPO, 2010 WL 3733873, at *6 (Bankr. S.D. Miss. Sep. 17, 2010) (denying constructive trust where claimant "does not, and cannot, allege that it was the victim of substantial overreaching or fraud") (internal quotation marks omitted); *In re* Herlan, No. 09-2665, 2010 WL 56019, at *1, *8–9 (Bankr. N.D. W. Va. Jan. 6, 2010) (imposing constructive trust in bankruptcy to recover contract documents misappropriated by claimant's broker), *aff'd*, 2010 WL 2024674 (N.D. W. Va. May 17, 2010), *aff'd*, 441 F. App'x 167 (4th Cir. 2011); Old Republic Nat'l Title Ins. v. Tyler (*In re* Dameron), 206 B.R. 394, 402 (Bankr. E.D. Va. 1997) (imposing constructive trust in bankruptcy to recover misappropriated escrow funds); AFCO Credit Corp. v. Baxco Corp. (*In re* Baxco Corp.), 148 B.R. 855, 861 (Bankr. N.D. Ill. 1992) (recognizing constructive trust in favor of fraud claimant).

[50] *See, e.g.*, *Chiu*, 16 F.3d at 310; *In re Herlan*, 2010 WL 56019, at *8–9; *Old Republic Nat'l Title Ins.*, 206 B.R. at 402.

[51] *See Graybill*, 806 F. App'x at 926; *Detiege*, 2022 WL 843374, at *1–2, *4; *Cruse*, 562 B.R. at 200–01; *Rajala*, 483 B.R. at 748–49; *AFCO Credit*, 148 B.R. at 861; *see also* Azhar Chaudhary Law Firm, P.C., 122 F.4th at 581.

[52] *See, e.g.*, Conn. Gen. Life Ins. v. Universal Ins., 838 F.2d 612, 619–20 (1st Cir. 1988) (not analyzing existence of "trust relationship" because of claimant's failure to trace adequately).

[53] *See, e.g.*, Heyman v. Kemp (*In re* Teltronics, Ltd.), 649 F.2d 1236, 1239 (7th Cir. 1981) ("[I]t is settled that property obtained by fraud of the bankrupt is not part of the bankrupt's estate") (citing Nicklaus v. Bank of Russellville, 336 F.2d 144, 146 (8th Cir. 1964)); *In re* Paragon Secs. Co., 589 F.2d 1240, 1242 (3d Cir. 1978));

Although finding a constructive trust may allow the claimant to take advantage of favorable tracing rules,[54] exclusion from the estate and constructive trust are similar concepts, and courts often treat them interchangeably.[55] This Article treats the two ideas as identical except where distinction is necessary.

II. SCHOLARLY ASSESSMENTS OF FRAUD PRIORITY

This section gives an overview of the scholarly discourse on constructive trust in bankruptcy, which has been the main vehicle for discussion of priority for fraud victims. Andrew Kull argues that constructive trust traditionally has been understood as a way to vindicate equitable title in cases of nonconsensual transfer of legal title. Emily Sherwin first argued that constructive trust in bankruptcy should be limited to cases where general creditors would be unjustly enriched, and later came to the view that constructive trust poses an unacceptable threat to the stability of property rights and should not be used at all in bankruptcy. Craig Rotherham also presents an account of constructive trust in bankruptcy that focuses on unjust enrichment, although he is less critical of its use than Sherwin. Hanoch Dagan argues that all involuntary claimants, not just claimants who could impose a constructive trust under existing doctrine, should enjoy priority in bankruptcy.

A. Constructive Trust as Vindication of Equitable Title

Professor Andrew Kull, Reporter of the *Restatement (Third) of Restitution and Unjust Enrichment*, has explained constructive trust as a way of recognizing equitable rights of the claimant in specific property: "A transfer creating a right to restitution is a transfer without an adequate legal basis, meaning a transfer that the law treats as ineffective to shift property rights in the thing transferred."[56] Transfers without an adequate legal basis are those that are

see also Walsh v. Townsquare Assocs. (*In re* Montross), 209 B.R. 943, 950 (B.A.P. 9th Cir. 1997) (no estate interest in account where all funds in account were funds "stolen" from claimant).

54 For example, if the debtor has exchanged the fraud-obtained property for more valuable property, the tracing rules allow a constructive trust to be imposed on the more valuable property. *See* Emily L. Sherwin, *Constructive Trusts in Bankruptcy*, 1989 U. ILL. REV. 297, 303–06.

55 *See, e.g.*, Torres v. Eastlick (*In re* N. Am. Coin & Currency, Ltd.), 767 F.2d 1573, 1575 (9th Cir. 1985); Drexel Burnham Lambert Inc. v. Flight Transp. Corp. (*In re* Flight Transp. Corp. Secs. Litig.), 730 F.2d 1128, 1136 (8th Cir. 1984); Fibre Form Corp. v. Slamin (*In re* Nova Tool & Eng'g, Inc.), 228 B.R. 678, 681–83 (Bankr. N.D. Ind. 1998).

56 Andrew Kull, *Restitution in Bankruptcy: Reclamation and Constructive Trust*, 72 AM. BANKR. L.J. 265, 277 (1998).

subject to rescission, including transfers induced by fraud.[57] Kull argues that the restitution claimant retains equitable title to such property.[58]

In bankruptcy, Kull writes, constructive trust provides the beneficiary a form of priority.[59] The critical question in deciding whether to grant such priority is whether denying restitution would result in "the creditors . . . in effect being paid with the claimant's money."[60] Put differently, the question is whether declining to grant a restitutionary remedy would result in a nonconsensual transfer of property the claimant (equitably) owns to the debtor's creditors.[61] This account is consistent with Kull's view of restitution "not as the law of unjust enrichment, but as the law of nonconsensual transfers."[62]

In the bankruptcy setting, Kull contends that restitutionary relief requires the claimant to show two things beyond what it would have to show in a nonbankruptcy setting. First, the claimant must be able to trace its property. For example, to trace money, the claimant must "point to an identifiable fund" and be able to "say 'this is my money' about . . . particular money in the hands of the debtor/trustee."[63] Second, the claimant must show that it is an "owner," rather than a "creditor." In Kull's account, the claimant accomplishes this by showing that "the law allows him to avoid the transfer by which the assets in question got into the debtor's hands."[64]

Transfers induced by fraud are generally avoidable and thus meet the second requirement for restitution in bankruptcy. The hurdle for fraud claimants would be the tracing requirement. Kull describes this requirement as an "arbitrary but intensely practical . . . rule[] of thumb"[65] for determining whether the initial defective transfer actually "increased the net assets available for distribution" at

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57 *Id.* at 281; ("Fraud or mistake makes a transfer subject to rescission."); *Id.* at 282 ("[T]he logic of restitution in a bankruptcy context starts as a matter of preserving the claimant's ownership of property that has come into the hands of the debtor by means of a nonconsensual transfer.").

58 *See id.* at 282. Although Kull uses the idea of equitable of ownership, he also argues that it is unnecessary to the conclusion: "The restitution claimant . . . prevails over the creditors because, unlike them, he has not consented to be a creditor of the debtor. Property obtained by fraud or mistake . . . has not come into the possession of the debtor by a voluntary transaction." *Id.* Importantly, in this passage, Kull is speaking of involuntary transfers of property, not involuntary creditor relationships in general. This distinguishes his position from Hanoch Dagan's. *See* discussion *infra* Part II.D.

59 *See* Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 284.

60 *Id.* at 274.

61 *See id.* at 278–79 ("[T]he claim in restitution is . . . that the debtor has possession and legal title of identifiable property that in equity belongs to the claimant.").

62 *See id.* at 266. In this context, Kull's assertion seems to be descriptive rather than normative in nature.

63 *See id.* at 283.

64 *See id.* at 284.

65 *See id.* at 283.

the time of bankruptcy.[66] This Article discusses tracing in more detail below,[67] but Kull recognizes that tracing fits awkwardly into an analysis of unjust enrichment, noting that general creditors may benefit from a defective transfer to the debtor even if the property is not traceable: "[T]he proceeds of [an] embezzlement, untraceably and profitably invested in a maze of commingled accounts, may have increased the bankruptcy estate more than dollar-for-dollar."[68]

B. Constructive Trust as Remedy in Tension with the Stability of Property Rights

Professor Emily Sherwin has published extensively on the subject of constructive trust in bankruptcy.[69] She has argued in earlier work for restricting,[70] and in later work for eliminating,[71] recognition of constructive trust in this setting.

Sherwin has focused on constructive trust's status as an equitable remedy,[72] arguing that the restitution claimant should not be viewed as having a property right in the trust res that preexists the judicial impression of the constructive trust[73]: "[D]ivided ownership is not a background legal fact recognized by the

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66 *See id.*

67 *See* discussion *infra* Part IV.

68 *See* Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 283.

69 *See, e.g.,* Emily L. Sherwin, *Why* In re Omegas Group *Was Right: An Essay on the Legal Status of Equitable Rights*, 92 B.U. L. REV. 885 (2012); Emily L. Sherwin, *Unjust Enrichment and Creditors*, 27 REV. LITIG. 141 (2007) [hereinafter "Unjust Enrichment"]; Emily L. Sherwin, *Rule-Oriented Realism*, 103 MICH. L. REV. 1578 (2005) (reviewing HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION (2004)); Sherwin, *supra* note 42, at 297.

70 *See* Sherwin, *supra* note 42, at 345–61 (arguing that constructive trust should not be used in bankruptcy: (1) to benefit claimants that suffered no quantifiable economic loss; (2) to allow claimants to recover appreciation of proceeds of trust property; (3) to allow the claimant to use the lowest-intermediate-balance rule to trace commingled funds; (4) to allow recovery where the claimant's dealings with the debtor were not sufficiently involuntary, including where the claimant's mistaken transfer of property was an "inherent risk of a commercial transaction"; (5) to allow recovery where creditors who relied on the debtor's ownership of property in question can validly assert laches or estoppel against the claimant).

71 *See, e.g.*, *Why* In Re Omegas Group *Was Right*, *supra* note 69, at 898 ("[I]n the context of insolvency, constructive-trust claimants are just a species of creditors, with no special 'equity' on their side."); *Unjust Enrichment*, *supra* note 69, at 153 ("My own preference would be for a rule denying priority to constructive trust claimants.").

72 *See* Sherwin, *supra* note 42, at 317 ("A constructive trust is not a right of ownership, but an equitable remedy against unjust enrichment.").

73 *See Unjust Enrichment*, *supra* note 69, at 150 (In cases where restitutionary entitlement is not governed by determinate rules, "the *Restatement's* reliance on equitable ownership is circular.").

declaration of a constructive trust, but a remedial conclusion settling a dispute about unjust enrichment."[74]

Sherwin first proposed in an influential article that constructive trust should be imposed only if a context-specific analysis of the claim and the debtor's circumstances showed that denying constructive trust would result in unjust enrichment of the general creditors.[75] She argued that priority was justified only where three conditions were met: (1) the creditors' gain would correspond to the claimant's loss; (2) property representing the unjust enrichment is traceable to the bankruptcy estate; and (3) the claimant is an involuntary creditor.[76]

In later writings, Sherwin argues that constructive trusts should not be recognized at all in bankruptcy.[77] She contends that case-by-case analysis of unjust enrichment is likely to produce "ad hoc" results, "based on judges' unstructured intuitions . . . ."[78] To be sure, a bright-line rule in favor of fraud victims might generally permit the restitution claimant to prevail over general unsecured creditors where the debtor has legal title to the assets in question. Sherwin argues, however, that such an approach introduces too much uncertainty into property relations, writing that "the benefits of clarity about property ownership should carry the day,"[79] so that constructive trust in bankruptcy should be rejected.

C. Constructive Trust as a Means of Combating Unjust Enrichment

Professor Craig Rotherham defends privileged treatment of restitutionary claims in bankruptcy on the ground of unjust enrichment: "[T]he paradigm case of a situation thought to justify priority involves a plaintiff who has involuntarily

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[74] *Why* In Re Omegas Group *Was Right*, *supra* note 69, at 892. In another of Sherwin's pieces, she argues:

> The equitable ownership associated with constructive trusts is not a property right equivalent to legal title to assets. Rather, it is a shorthand expression describing the conclusion that, as between a particular restitution claimant and a particular defendant, the court should grant a remedy that reallocates property rights to the claimant.

Sherwin, *Unjust Enrichment*, *supra* note 69, at 145–46.

[75] *See* Sherwin, *supra* note 42, at 351 (In assessing whether defrauded claimant's dealings with the debtor were involuntary enough to justify constructive trust, "[t]here are many variations of fraud, and the constructive trust claimant's position in comparison to other creditors will depend on specific facts about his transaction with the debtor.").

[76] *See id.* at 329–40.

[77] *See Why* In Re Omegas Group *Was Right*, *supra* note 69, at 898 ("In my view, the benefits of clarity about property ownership should carry the day: in the context of insolvency, constructive-trust claimants are just a species of creditors, with no special 'equity' on their side.").

[78] *Unjust Enrichment*, *supra* note 69, at 153.

[79] *See Why* In Re Omegas Group *Was Right*, *supra* note 69, at 898.

enriched the defendant's estate so that there is an increase in the value of the assets that would be available for distribution in bankruptcy were a proprietary remedy not given."[80]

Rotherham does not rely, as Kull does, on property-law concepts as the basis for priority for restitutionary claimants. Indeed, he finds a justification for priority based primarily on the claimant's property rights to be circular: "The very question that needs to be resolved . . . is in what circumstances we should confer rights which will have the effect of conferring priority in bankruptcy."[81] In this sense, he appears to agree with Sherwin, although without the latter's concern for priority's effect on the stability of property.

Like both Kull and Sherwin, Rotherham finds the defect in transfers giving rise to constructive trust in the involuntariness of the transferor's action rather than in the culpability of the transferee. In contrasting tort and restitution claims, he notes that both "may be regarded as dealing with the aftermath of 'accidents.'"[82] The distinguishing feature of an accident is that it is involuntary. Rotherham notes the "plausible intuition that to allow creditors to have recourse to assets gained without plaintiffs' real consent would show a lack of respect for the autonomy of such plaintiffs and so would result in the unjust enrichment of the defendant's creditors."[83] The focus is on consent and autonomy, not, for example, culpability and deception.

D. Constructive Trust as Indefensible Means of Favoring Some Involuntary Creditors

Professor Hanoch Dagan offers a normative challenge to any version of bankruptcy priority that is limited to restitutionary claims. He argues that, from a normative standpoint, all involuntary creditors in bankruptcy are equally entitled to priority, so that there is no reason to favor restitution claimants over garden-variety tort claimants.[84] In so doing, Dagan recognizes that existing law does distinguish between these two categories of claimants.[85] As shown, constructive trust is at least theoretically available in most jurisdictions to give

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80 CRAIG ROTHERHAM, PROPRIETARY REMEDIES IN CONTEXT 86 (2002).

81 *Id.* at 78.

82 *Id.* at 81.

83 *Id.*

84 *See* Hanoch Dagan, *Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred*, 78 AM. BANKR. L.J. 247, 248–49 (2004).

85 *See id.* 249; *see also* Sherwin, *Rule-Oriented Realism*, *supra* note 69, at 1588 (reviewing HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION (2004)) ("Dagan . . . recognizes that a move of this kind would require a radical reshaping of overall bankruptcy policy[.]").

restitution claimants priority over general creditors,[86] while tort victims who have not enriched the estate generally enjoy no priority under the Code.[87]

Dagan attacks the normative basis of the positive law, arguing that "proponents of the unjust enrichment school must show not only why [restitution] claimants are entitled to a reward, but also (1) what that reward should be and (2) why it should come at the expense of other creditors."[88] He concludes, "It is difficult to see how these two challenges can be successfully addressed,"[89] and finds on that basis that "tort victims and restitution claimants are similarly situated."[90] Importantly, Dagan's argument supports priority for fraud claimants in bankruptcy, although he would not limit priority to this group.

III. Normative Basis for Fraud Priority

This Part explains the normative basis for fraud priority. Part III.A defines the terms "fraud" and "priority." Part III.B presents the argument that, in addition to the traditional justification that constructive trust rectifies involuntary transfers that enrich the estate, fraud priority is justified because fraud is normatively wrong. Principles that parties should not profit from wrong at the expense of the victim and that victims of wrongdoing should be compensated thus support fraud priority.

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86 *See* discussion *supra* Part I.B.

87 *See* 11 U.S.C. § 507 (listing priority claims in bankruptcy without providing priority for tort victims other than claimants for death or personal injury arising from operating a motor vehicle or vessel under the influence).

88 Dagan, *supra* note 84, at 271.

89 *Id.* at 272.

90 *Id.* Sherwin later found this argument convincing at least in part, writing that "Dagan may be correct that contribution has no normative significance[,]" but noting, "[i]t is possible that contribution has psychological significance that should be recognized by law." Sherwin, *Rule-Oriented Realism*, *supra* note 69, at 1587 n.27 (2005) (reviewing HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION (2004). Even at this point, Sherwin wrote that she "might diverge from his conclusion that all involuntary creditors should have priority." *Id.*

A. *Defining "Fraud" and "Priority"*

1. *Fraud*

"Fraud" notoriously has a wide range of meanings. For example, its definition varies between common-law fraud[91] and consumer fraud.[92] In the criminal context, difficult problems can arise in defining whether novel conduct fits into open-textured fraud prohibitions.[93]

For the normative argument advanced in Part III.B, the most important aspect of fraud is that it is wrong. The fraudster is thus a wrongdoer, and those who profit from the fraud profit from wrongdoing. Although any conduct actionable as fraud could be described as legally wrong, opinions might vary on whether some conduct the law designates as fraudulent is normatively wrong. For example, an action for fraudulent conduct under California's Unfair Competition Law does not require proof of any particular mental state, so "innocent" representations that are likely to deceive members of the public are actionable.[94] Some might balk at characterizing the making of such representations as wrongdoing.

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[91] In the leading commercial jurisdiction of New York, the elements of common-law fraud have been described as, "(1) a misrepresentation or omission of a material fact; (2) that the defendant knew to be false; (3) that the defendant with the intent of inducing reliance; (4) upon which the plaintiff reasonably relied; and (5) that caused injury to the plaintiff." Koziar v. Blammo, Ltd., 759 F. Supp. 3d 543, 551 (S.D.N.Y. 2024) (quoting Hunt v. Enzo Biochem, Inc., 530 F. Supp. 2nd 580, 592 (S.D.N.Y. 2008)).

[92] For example, the California Supreme Court has held that consumer-fraud cases sounding in false advertising under the state's Unfair Competition Law need only "show that members of the public are likely to be 'deceived.'" *In re* Tobacco II Cases, 207 P.3d 20, 29 (Cal. 2009) (quoting Kasky v. Nike, Inc., 45 P.3d 243 (Cal. 2002)). More recently, the court reaffirmed that the UCL "eliminate[s] a number of elements that were required in common law actions for fraud." Nationwide Biweekly Admin. v. Super. Ct., 462 P.3d 461, 485 (Cal. 2020). In particular, "intent to deceive" need not be alleged. *See* Don v. Unum Grp., No. 13-4502, 2014 WL 12597144, at *5 (C.D. Cal. Aug. 2014).

[93] *See generally* Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971 (2006) (discussing how courts decide whether to treat "novel commercial behaviors" as frauds, given fraud law's "open-textured, common law, and adaptive qualities"). As an example of such an open-ended provision, Buell uses Section 371 of Title 18 of the U.S. Code. Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 1973 n.4 (2006); *see* 18 U.S.C. § 371 ("If two or more persons conspire . . . to defraud the United States . . . and one or more of such persons do any act to effect the object of the conspiracy, each shall be [punished].").

[94] For example, the California Supreme Court has held that consumer-fraud cases sounding in false advertising under the state's Unfair Competition Law need only "show that members of the public are likely to be deceived." *In re Tobacco II*, 207 P.3d at 29 (quoting Kasky v. Nike, Inc., 45 P.3d 243 (2002)). More recently, the court reaffirmed that the UCL "eliminate[s] a number of elements that were required in common law actions for fraud." *Nationwide Biweekly Admin.*, 462 P.3d at 485. In particular, "intent to deceive" need not be alleged. *See Don v. Unum*, 2014 WL 12597144 *5.

But there seems to be general agreement that fraud involving intentional deception is wrong.[95] The Supreme Court recently recognized "deception" as a form of "wrongdoing."[96] Thus, when this Article refers to "fraud," it means "conduct the law recognizes as fraudulent that involves intentional deception." The intentional-wrongdoing definition generally seems to follow the mens rea requirement for nondischargeability of fraud debt under section 523(a)(2).[97] This Article leaves to the side the question of whether fraud involving some lesser degree of culpability should also give rise to priority claims.

A premise of this Article's argument is that the fraud in question enriches the debtor at the expense of the victim. This premise generally will be satisfied in the common case where the victim transfers property, including money, to the perpetrator. It may also be satisfied in cases where the victim provides valuable services that measurably enrich the estate,[98] but the Article leaves that question to the side as well.

The fraud-victim claimant seeking restitution in the criminal context commonly must be innocent of the crime to succeed.[99] The Article likewise assumes that the victim has not engaged in wrongdoing respecting the transaction in question.

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[95] *See* 4 COLLIER ON BANKRUPTCY ¶ 523.08[e] (16th ed. 2025) ("The key element of a nondischargeability claim for actual fraud under section 523(a)(2)(A) is the scienter requirement. The underlying conduct must involve moral turpitude or intentional wrong.") (internal quotation marks omitted).

[96] *See* Kelly v. United States, 590 U.S. 391, 393 (2020) (recognizing "deception" as a type of "wrongdoing" in a fraud case); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976) (in a fraud case, where "a statute speaks [of] . . . deception," it uses "the commonly understood terminology of intentional wrongdoing").

[97] *See* 11 U.S.C. § 523(a)(2)(B)(iv) (requiring "intent to deceive" for nondischargeability of debt incurred use a false statement of financial condition); COLLIER ON BANKRUPTCY, *supra* note 95, ¶ 523.08[e] (As to nondischargeability for actual fraud under section 523(a)(2)(A), "[t]he key element . . . is the scienter requirement. The underlying conduct must involve moral turpitude or intentional wrong.") (internal quotation marks omitted); *Id.* ¶ 523.08[d] (As to nondischargeability for false representations not involving statements of financial condition or "actual fraud," the mens rea requirement is that the statement be "knowingly and fraudulently made," only potentially including "reckless representations.").

[98] *Compare* 11 U.S.C. § 523(a)(2) (providing that debts arising from fraudulent procurement of services are nondischargeable) *with* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 551(1) (A.L.I. 2011) (constructive trust available in certain cases where "a defendant is unjustly enriched by the acquisition of title to identifiable property" and would not be available where the victim provides services rather than transferring property).

[99] *See, e.g.*, 21 U.S.C. § 853(i)(1) (authorizing Attorney General to "restore forfeited property to victims . . . or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this section."); United States v. Quatrella, 722 F. App'x 64, 69 (2d Cir. 2018) (upholding order of restitution to investors in fraudulent scheme where "there is no evidence that any of the investors were knowing participants in the scheme").

2. *Priority*

This Article argues for priority of fraud claims over general unsecured claims. It does not argue for priority of fraud claims over secured claims.

To be sure, the argument of the Article, that creditors should not profit from wrongdoing at victims' expense, could apply to secured creditors. For example, consider a debtor that has executed a security agreement with an after-acquired property clause that grants a security interest in equipment.[100] Now assume that the debtor acquires equipment through fraud, reducing the amount by which the creditor is undersecured. Denying priority to the fraud claimant over the secured claim could unjustly enrich the secured creditor.

However, expanding priority for fraud claimants beyond what the state-law rules governing priority contests already allow[101] raises constitutional issues that are beyond the scope of this Article.[102] Moreover, the literature to which this Article responds focuses on the contest with unsecured creditors.[103]

B. *Fraud as an Especially Strong Basis for Claim of Unjust Enrichment*

Where fraud has induced a transfer to the debtor and the transfer presumptively has enriched the estate, the victim has a stronger normative claim to any increment of value resulting from the fraud than the general creditors.[104] As shown, the positive law by and large already reflects this principle: most

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[100] *See* U.C.C. § 9-204(a) (A.L.I. & UNIF. L. COMM'N 2025) (validating after-acquired property clauses).

[101] State law provides rules for priority contests between security interests and constructive trusts. *See* MBK Servs. v. Cole Taylor Bank, No. 1-12-3026, 2013 WL 5436652, at *14–15 (Ill. App. Ct. Sept. 26, 2013) (commenting on issues raised in priority contest between constructive trust and security interest).

[102] *See, e.g.*, Louisville Jt. Stock Land Bank v. Radford, 295 U.S. 555, 578–89 (1935); H.R. REP. NO. 95-595, at 339 (1977) (requirement of adequate protection of secured claims is "derived from the Fifth Amendment protection of property interests."); WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW & PRACTICE § 151:12 (3d ed. 2025) ("The secured claim holder's constitutionally protected property right is its allowed secured claim; that is, the value of collateral up to, but not exceeding the amount due under the contract with the debtor . . . .").

[103] *See, e.g.*, Dagan, *supra* note 84, at 271; Kull, *supra* note 56, at 265; Sherwin, *supra* note 42, at 329.

[104] Some form of this argument dates at least back to Dean James Barr Ames's 1906 article in the *Harvard Law Review*. He argued that where misappropriated property cannot be traced, but "the court is convinced that the fund for distribution among the creditors of the wrongdoer is larger than it would have been but for the misappropriation," then the victim "should be treated as a preferred creditor as to the excess of the actual fund for distribution above what it would have been if the misappropriation had not been made." By contrast, where "it is impossible to prove that the fund for distribution among the general creditors is, at the time of the preference allowed, larger than it would have been but for the misappropriation," the victim should receive no preference, because that would "mean[] an unfair reduction of the dividend of the other creditors." James Barr Ames, *Following Misappropriated Property into Its Product*, 19 HARV. L. REV. 511, 521–22 (1906). Part IV.C takes up the issues of proof Ames identifies.

jurisdictions permit constructive trust in bankruptcy in general and at least notionally for fraud victims in particular.[105]

As among claimants who might succeed in imposing a constructive trust under current law, fraud victims arguably are especially deserving because wrongdoing induced the claimant's transfer to the debtor. The fraud claimant is a victim, not just an involuntary transferor. Such a victim can be said to occupy a stronger position than one who transfers property to the debtor through its own mistake.[106]

Two higher-level normative principles support the claim that fraud victims seeking recovery of their own loss are especially deserving. Neither principle is universally observed throughout the law, and both principles are qualified when expressed in specific doctrines. But both normative principles at least arguably underlie aspects of positive law.

The Article's epigraph suggests the first principle: a third party—even an innocent one—should not benefit from a wrong at the expense of the victim. Thus, the innocent ex-spouse who receives embezzled money paid under a divorce agreement must return it to the owner.[107] The innocent business partner of a fraudster cannot discharge fraudulently incurred debts in bankruptcy.[108] The innocent recipient of a fraudulent transfer must return it.[109] Indeed, vindicating this principle arguably is the core purpose of constructive trust.[110] The principle against benefiting from wrongdoing at the expense of the victim is violated if

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105 *See* discussion *supra* Part I.B.

106 Scholars have not distinguished between these classes of transferors on this ground. *See* Sherwin, *supra* note 42, at 357–58; Kull, *supra* note 56, at 289; Dagan, *supra* note 84, at 265.

107 *See* Landers v. Wabash Ctr., Inc., 983 N.E.2d 1169, 1173–75 (Ind. Ct. App. 2013). Although the court states at one point that the ex-spouse had reason to know of the embezzlement, the court's reasoning appears to be based only on the ex-spouse's benefit. *See* Landers v. Wabash Ctr., 983 N.E.2d 1169, 1174 (Ind. Ct. App. 2013).

108 *See* Bartenwerfer v. Buckley, 598 U.S. 69, 73–74, 83 (2023) (upholding reversal of decision that business partner of fraudster may discharge debt arising from fraud unless the partner knew or had reason to know of the fraud).

109 *See* UNIF. VOIDABLE TRANSACTIONS ACT, §§ 4–5 (UNIF. L. COMM'N 2014). A transferee who acts in good faith does, at a minimum, have a lien on the property for actual value given. UNIF. VOIDABLE TRANSACTIONS ACT, § 8(d)(1) (UNIF. L. COMM'N 2014). Further discussion of fraudulent transfer law, including the status of subsequent transferees, good-faith transferees who give reasonably equivalent value, of transfers that reflect actual versus fraud, and so forth, is beyond the scope of this Article.

110 *See* DOBBS, *supra* note 36, at 6–7 (constructive trust is "typically . . . invoked against fiduciaries who have embezzled funds, or misappropriated a corporate opportunity; or against persons who have obtained money by fraud or duress"). Given that such wrongdoers generally could, if solvent, be made to repay via a money judgment, constructive trust arguably is important only where it permits the claimant to prevail over third parties: "innocent takers" of the property who are not bona fide purchasers, or rival creditors in the case of insolvency. *See id.* at 7.

the general creditors receive the increment to the debtor's worth that results from the fraud, because the general creditors are profiting from the victim's loss.

The second principle is that victims of wrongdoing should be compensated. Crime victims[111] and the wrongfully convicted[112] are in some jurisdictions compensated at taxpayer expense. The innocent purchaser of stolen property other than money must return it to the victim.[113] The preceding examples show that the compensation principle sometimes operates even at the expense of innocent third parties, but that issue is not even clearly presented here. When the fraud claimant recovers only the increment of value attributable to the fraud, the general creditors are properly viewed not as losing, but as being prevented from gaining.[114]

Thus, this Article provides an additional justification for the law's existing willingness to allow fraud victims priority in bankruptcy. The Article contends that the defrauded claimant should prevail over the innocent creditor not only because the victim's transfer was arguably involuntary, but because the claimant is a victim of wrongdoing. Application of this unjust enrichment-based rationale is triggered by a wrongful transfer of property, but its logic targets enrichment rather than the specific item of property transferred.

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[111] *See, e.g.*, CAL. PENAL CODE §§ 4900–06 (West 2025). In California, payments under the program are contingent on the Legislature's appropriation of funds. CAL. PENAL CODE § 4900(b) (West 2025).

[112] *See generally* JEREMY LEVINE, UNIV. OF MICH. CTR. FOR RACIAL JUST. & UNIV. OF MICH. POVERTY SOLS., INEQUALITY IN CRIME VICTIM COMPENSATION (2024), https://poverty.umich.edu/publications/inequality-in-crime-victim-compensation/ (discussing such programs).

[113] *See, e.g.*, Cassirer v. Thyssen-Bornemisza Collection Found., 862 F.3d 951, 960 (9th Cir. 2017) ("Under California law, thieves cannot pass good title to anyone, including a good faith purchaser. This is also the general rule at common law."); Friedman v. Wahrsager, 848 F. Supp. 2d 278, 296 (E.D.N.Y. 2012); H.E.B., L.L.C. v. Ardinger, 369 S.W.3d 496, 508 (Tex. Ct. App. 2012); RESTATEMENT (SECOND) OF TORTS § 229 cmt. d (A.L.I. 1977). The innocent seller of stolen property is, as a default under the UCC's warranty of title, liable to the buyer who returns the property to the victim in this case. *See* U.C.C. § 2-312(1)(a) (A.L.I. & Unif. L. Comm'n 2025).

[114] The general rule is said to be that creditors that have already been paid enjoy an affirmative defense to restitution claims of which they had no notice at payment. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 (A.L.I. 2010). The fact of payment is critical to this rule, as "[t]he usual modern justification of [the] rule refers to the special interests of finality in payment transactions, rather than (or even at the expense of) considerations of equity between the parties." RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT cmt. b (A.L.I. 2010). Thus, this rule would not apply to administration of a bankruptcy estate when claims have not yet been paid. In any event, the rule's breadth has been criticized, as the *Restatement* commentary suggests. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT cmt. b. (A.L.I. 2010) ("If the court believes . . . that the equities of the parties outweigh the interests of finality and ease of adjudication, it can require as a condition of the innocent payee's affirmative defense a showing of change of position . . . ."). Andrew Kull, Reporter for the *Restatement*, has criticized overbroad application of the rule of Section 67 in two recent articles. *See* Andrew Kull, *The Fallacies of "Discharge for Value"*, 44 REV. LITIG. 285, 312 (2025) (providing hypothetical revision of section 67 to narrow its application to cases of "commercial necessity"); Andrew Kull, *Victim v. Victim Restitution: The Commingling Fictions*, 51 ST. MARY'S L.J. 309, 314 (2020) (referencing "perceptible sense that the rule does not do justice" when applied between fraud victims).

IV. FRAUD PRIORITY SHOULD NOT REQUIRE TRACING

Part IV explains why fraud claimants should not have to trace assets, at least under current tracing doctrine, to achieve priority. Part IV.A describes the tracing requirement under current law. Part IV.B argues that current tracing requirements fit poorly with the underlying objective of constructive trust and fraud priority generally, namely combating unjust enrichment. Part IV.C describes the once-popular "swollen-assets" approach to tracing, which presumed continued enrichment of the fraud defendant once acquisition of assets through fraud was shown. A return to the swollen-assets doctrine is one way of aligning constructive-trust doctrine more closely with the goal of avoiding unjust enrichment.

A. The Tracing Requirement Under Current Law

Under current law, priority for fraud claims in bankruptcy is achieved, if at all, through constructive trust. Constructive-trust doctrine requires the claimant to identify specific property in the hands of the constructive-trust defendants, a process called "tracing."[115]

Standard tracing doctrine allows a wronged party to impose a constructive trust not just on the lost property itself, but also on the property's identifiable proceeds and products in the hands of the defendant.[116] Moreover, if funds acquired through fraud are commingled with other funds in an account, the claimant benefits from the "lowest intermediate balance rule," which assumes that expenditures from the account come from the non-trust funds first.[117]

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115 *See* Cosmetic Plus Grp., Ltd. v. Gowan (*In re* Dreier LLP), 683 F. App'x 78, 80 (2d Cir. 2017) ("It is hornbook law that before a constructive trust may be imposed, a claimant to a wrongdoer's property must trace his own property into a product in the hands of a wrongdoer."); Chi. Title Ins. v. Sinikovic, 125 F. Supp. 3d 769, 780–81 (N.D. Ill. 2015); *In re* Wash. Mut., Inc., 450 B.R. 490, 504 (Bankr. D. Del. 2011); Wall Sys., Inc. v. Pompa, 154 A.3d 989, 1005 (Conn. 2017); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55(1) (A.L.I. 2011) (subject of constructive trust is identifiable misappropriated property and "its traceable product"); DOBBS, *supra* note 36, at 5 ("identified fund or property"); "Tracing" is sometimes used in a narrower sense, to cover only the situation where the claimant reaches property other than what was originally misappropriated. *See* Dale A. Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 CORNELL L. REV. 172, 173 (1983).

116 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 58(1) (A.L.I. 2011); DOBBS, *supra* note 36, at 5–6.

117 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 59 (A.L.I. 2011); DOBBS, *supra* note 36, at 22–23. *But see* Kull, *Victim v. Victim Restitution*, *supra* note 114, at 342–43 (referring to the lowest intermediate balance rule as the "rule of Jessel's bag" and arguing that the presumption "has nothing whatever to do with the facts and usually flies in their face").

Despite these pro-claimant aspects of tracing, its core is the identification of specific property, and such identification is the key to fraud-claim priority under current law.[118] This section argues that, if combating unjust enrichment is the theory underlying fraud priority, current tracing law is a poor fit for the goal. Contemporary tracing rules emphasize transactional links between misappropriated property and property in the hands of the defendant, while combating unjust enrichment calls for a causal analysis of enrichment.[119]

B. *Mismatch of Tracing and Unjust Enrichment*

Constructive trust reportedly began as a way to recover assets from trustees that misappropriated them and exchanged them for other assets.[120] The tracing rules are property-identifying rules. They can be understood as reflecting the principle that the ownership of a piece of property entitles one to ownership of the proceeds and products of that property. That is, the property "must be restored . . . even if the property has undergone a change in form by reason of an exchange or otherwise."[121] As an English court explained the principle in 1879, referring to sales of trust property by a trustee, "You can, if the sale was rightful, take the proceeds of the sale if you can identify them. If the sale was wrongful, you can still take the proceeds of sale . . . if you can identify them."[122] The wrongful nature of the sale of property did not destroy the right to the proceeds of sale.

Given this history, one could argue that the tracing requirement vindicates restitution's concern with the nonconsensual transfer of specific property. Recall Kull's description of the field "not as the law of unjust enrichment, but as the law of nonconsensual transfers."[123] It could be argued that the tracing requirement appropriately limits relief to the nonconsensually transferred property and its products and certain substitutes. It is not entirely clear what principle underlies the outer limits of tracing doctrines under this formulation;[124]

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118 *See* discussion *supra* Part I.B.

119 The distinction between transactional and causal links goes back at least as far as 1982. *See* Oesterle, *supra* note 115, at 203–04.

120 *See id.* at 186–88.

121 *See* DOBBS, *supra* note 36, at 11; *see also id.* at 12 (repeating the "changed form" metaphor twice).

122 Knatchbull v. Hallett (*In re* Hallett's Estate), 13 Ch D 696, 708–09 (1879); *see also* JOHN P. DAWSON, UNJUST ENRICHMENT: A COMPARATIVE ANALYSIS 28 (1951) (the argument in favor of tracing into property exchanged without an owner's consent was that "[A]n owner should not be worse situated in a court of equity because the defendant had acted wrongfully from the outset.").

123 Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 266.

124 *See* ROTHERHAM, *supra* note 81, at 106 (criticizing conventional explanations of tracing law for relying on a "mysterious essence that passes from one asset to another").

the "change in form" idea is just a metaphor.[125] But in any event, contemporary commentators do not describe the remedy this way.

Instead, commentators identify combating unjust enrichment as the remedy's goal,[126] and they call the tracing rules proxies or rules of thumb used in achieving that goal.[127] Oesterle argues that the tracing rules function poorly[128] because they emphasize transactional links between items of property rather than on causative links between wrongful transfer and enrichment.[129] Other commentators find the rules more effective as a measure of enrichment,[130] but they accept the basic principle that the tracing rules function as a proxy for causation of enrichment. Courts appear less likely to comment on the purpose of the tracing rule, but they generally share the view that the device's ultimate purpose is combating unjust enrichment.[131]

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125 To be sure, the "change in form" metaphor has found favor with courts. *See, e.g.*, United States v. Inc. Vill. of Island Park, 888 F. Supp. 419, 457 (E.D.N.Y. 1995); Meoli v. Kendall Elec., Inc. (*In re* R.W. Leet Elec., Inc.), 372 B.R. 846, 858 (6th Cir. B.A.P. 2007); Notinger v. Migliacco (*In re* Fin. Res. Mortg., Inc.), 468 B.R. 487, 509 (Bankr. D.N.H. 2012); Anderson v. Broker, Inc. (*In re* Brokers, Inc.), 396 B.R. 146, 165 (Bankr. M.D.N.C. 2008).

126 *See* ROTHERHAM, *supra* note 81, at 86; DOBBS, *supra* note 36, at 11 ("The purpose of constructive trust . . . is to require restitution to prevent unjust enrichment."); Sherwin, *supra* note 42, at 299 ("The substantive basis for imposing a constructive trust is unjust enrichment represented by property."); Oesterle, *supra* note 115, at 176 n.9 ("As far back as 1888, commentators sought to unify the application of [several] ancient doctrines under the mantle of unjust enrichment, and in 1936 the Restatement of Restitution recognized and legitimized the new field."). Although Andrew Kull describes the fundamental issue as "nonconsensual transfer" rather than "unjust enrichment," he finds that the "overriding causation problem . . . is the question of the extent . . . to which the initial nonconsensual transfer from claimant to debtor has increased the net assets available for distribution in bankruptcy." Kull, *supra* note 56, at 283. He finds the tracing rules "simply rules of thumb" in this inquiry, rules that are "arbitrary" but "intensely practical." *Id.*

127 *See* Dagan, *supra* note 84, at 259 ("rules of thumb"); Kull, *supra* note 56, at 283 ("rules of thumb"); Sherwin, *supra* note 42, at 333 ("rough measure"); Oesterle, *supra* note 115, at 190 ("crude rule of thumb").

128 *See* Oesterle, *supra* note 115, at 203–04 (arguing that arbitrary distinctions between claimants arise because of "[t]he primacy of a transactional link over a causal link in the law of tracing").

129 *See id.* at 197 ("consequences based on physical rather than causal events").

130 *See* Kull, *supra* note 56, at 283 (tracing rules are "intensely practical" and based on "common-sense assumptions").

131 *See, e.g.*, Rent-A-Center E., Inc. v. Leonard (*In re* Web2B Payment Sols., Inc.), 815 F.3d 400, 407 (8th Cir. 2016) (quoting Koberg v. Jones, 157 N.W.2d 47, 52 (Minn. 1968)) (constructive trust is "intended to prevent unjust enrichment"); Pender v. Bank of America, 788 F.3d 354, 368–69 (4th Cir. 2015) (first quoting Variety Wholesalers, Inc. v. Salem Logistics Traffic Servs., LLC, 723 S.E.2d 744, 751 (N.C. 2012); then quoting Smithberg v. Ill. Mun. Ret. Fund., 735 N.E.2d 560, 565 (Ill. 2000) ("A constructive trust may be 'imposed by courts of equity to prevent . . . unjust enrichment'" or "to avoid unjust enrichment")); United States v. Ramunno, 599 F.3d 1269, 1274 (11th Cir. 2010) (quoting Troutman v. Troutman, 676 S.E.2d 787, 790 (Ga. Ct. App. 2009) ("[A] constructive trust is a remedy created by a court in equity to prevent unjust enrichment.")); Sulzer v. Diedrich, 664 N.W.2d 641, 645 (Wis. 2003) (citing Wilharms v. Wilharms, 287 N.W.2d 779, 783 (Wis. 1980)) ("A constructive trust is an equitable device used to prevent unjust enrichment."); City of Atlanta v. Hotels.com, L.P., 775 S.E.2d 276, 280 (Ga. Ct. App. 2015) ("A constructive trust is an equitable remedy imposed by a court to prevent unjust enrichment.").

However well or poorly tracing might work under a notion of constructive trust that focuses solely on property rights, it is a poor fit when constructive trust is based on avoiding unjust enrichment. Professors James White and Lawrence Summers memorably described Uniform Commercial Code section 2-207 as "like an amphibious tank that was originally designed to fight in the swamps, but was sent to fight in the desert."[132] A similar observation applies to the tracing requirement as a way of identifying unjust enrichment. Tracing would work well in this application only fortuitously.

As a measure of unjust enrichment, traceability is both over- and underinclusive. The defendant apparently cannot defend on the ground of lack of enrichment if property is traceable, and the claimant cannot argue enrichment if no property is traceable.[133] But traceability is possible without enrichment, and vice versa. Consider two scenarios, each starting with a fraudster gaining ten marked $100 bills from a victim through deceit.[134]

In Scenario A, the fraudster, emboldened by the $1,000 gain, places a bet that the fraudster otherwise would not have placed, stakes ten $100 bills that it owned before the fraud, and loses them. The fraudster is no longer enriched by the fraud. Although the fraudster was temporarily enriched, distribution of the $1,000 obtained from the victim to the fraudster's creditors would not enrich them relative to the situation where the fraud never occurred. But the victim could achieve priority as to "its" $1,000 by identifying the marked bills still in the fraudster's possession. If the goal of constructive trust is to combat unjust enrichment, this result is incorrect, as the fraud did not enrich the creditors, unjustly or otherwise.

In Scenario B, the fraudster places a $1,000 bet that it was going to place anyway, staking the ten $100 bills acquired from the victim and losing them. Now, the fraudster is enriched by the fraud, as it has $1,000 that it would not have had absent the fraud. The distinction is that in Scenario A, but not Scenario B, the fraud gain caused the gambling loss. But the victim cannot trace "its" $1,000 to the fraudster, as the bills are gone.[135] Constructive trust relief is denied. In bankruptcy, the creditors would be enriched by the fraud if the $1,000 were

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132 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 1–3 (7th ed. 2022).

133 *See* Oesterle, *supra* note 115, at 213.

134 For many examples along similar lines, see Oesterle, *supra* note 115, at 172 *passim*.

135 At least under the *Restatement*'s approach, the victim would be able to impose a constructive trust on the $1,000 in the hands of the bet's winner, assuming the victim could find the marked bills and assuming that the winner is not a bona fide purchaser or bona fide payee. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 58(2) (A.L.I. 2011).

distributed to them. Under the argument of this Article, the enrichment is unjust, as the creditors are profiting from the fraud.

C. Swollen-Assets Theory

At one time, a theory that largely relieved the claimant of the responsibility to identify property in the debtor's hands at the time of distribution was popular.[136] Under the "swollen-assets" theory, a restitution claimant that could show a wrongful transfer to an insolvent recipient was permitted to recover the full value of its claim (at the expense of the general creditors) without making a separate showing that the defendant still had property traceable to the wrongful transfer in its possession at the time of the distribution.[137] As the Iowa Supreme Court noted, "[I]f property impressed with a trust has been 'traced' to the possession of the trustee, the burden is then upon him or his receiver to show that it did not result in augmentation of the estate."[138] This approach reportedly reached its zenith in the Great Depression, when it was used to favor bank depositors.[139]

The *Restatement (Third) of Restitution and Unjust Enrichment* relays in a comment that the swollen-assets doctrine is "uniformly rejected in modern U.S. law."[140] The *Restatement* comment may overstate the case at least slightly: the Supreme Court of Nebraska appears to have applied the doctrine to trace constructive-trust property in 1993.[141] Even so, the author's research indicates that the swollen-assets doctrine is no longer widely used.[142]

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136 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 58 cmt. e (A.L.I. 2011) ("Courts of an earlier era sometimes accepted and sometimes repudiated a doctrine of 'swollen assets . . . .'"); GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, BOGERT'S THE LAW OF TRUSTS AND TRUSTEES § 922 (2025) ("[I]n a large number of . . . cases the beneficiary has been allowed to" use the swollen assets doctrine); Oesterle, *supra* note 115, at 189.

137 *See* BOGERT, BOGERT & HESS, *supra* note 136, § 922 (explaining swollen assets doctrine).

138 Andrew v. State Bank of New Hampton, 217 N.W. 250, 253 (Iowa 1928).

139 *See* Oesterle, *supra* note 115, at 189 n.33.

140 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 58 cmt. e (A.L.I. 2011) (referring to the "much-contested but now rejected doctrine of 'swollen assets'"). The first *Restatement of Restitution* also required tracing, but it did not explain why. *See* RESTATEMENT OF RESTITUTION § 215(1) (A.L.I. 1937); *see also* RESTATEMENT OF RESTITUTION § 215(1) cmt. a (A.L.I. 1937) ("[I]f it is shown that the property or its proceeds have been dissipated so that no product remains, [the restitutionary] claim is only that of a general creditor of the wrongdoer."). Leaving the conclusion—if not the reasoning—crystal clear, the comment continues, "The rule [denying recovery where misappropriated property has been dissipated] is applicable although it is proved that if the wrongdoer had not dissipated the property of the claimant he would have dissipated other property which he still holds." RESTATEMENT OF RESTITUTION § 215(1) cmt. a (A.L.I. 1937).

141 *See* N. Bank v. Fed. Deposit Ins. Corp., 496 N.W.2d 459, 465–66 (Neb. 1993).

142 The author has turned up no recent case outside of Nebraska applying the "swollen assets" theory under that name. An Iowa case from 1985 recognized the continuing viability of the doctrine but found that no trust existed under the facts before it. *See* Huston v. Exch. Bank, 376 N.W.2d 624, 627 (Iowa 1985).

But it is not clear why the swollen-assets theory lost favor. The *Restatement* gives no explanation. It cites Bogert's treatise on trusts, which offers a criticism of the swollen-assets theory.[143] As discussed below, this criticism is flawed. It depends on transactional links rather than causal links—an approach that might be appropriate for determining whether property has changed form, but is less appropriate for measuring enrichment.[144]

Bogert's argument runs as follows. He asks us to consider a trustee who starts off with $1,000 cash, a $1,000 bond, and $5,000 in general liabilities. The trustee also holds $1,000 in trust. Bogert then asks us to imagine that the trustee misappropriates the $1,000 held in trust and combines it with its own $1,000 cash to repay $2,000 in general liabilities. In so doing, the trustee incurs a $1,000 restitutionary liability to the trust beneficiary. After the transactions, the trustee has a $1,000 bond and owes a total of $4,000 ($3,000 to the remaining general creditors and $1,000 to the restitution claimant). Bogert notes that at the end of the transactions, the trustee's net worth is negative $3,000, just the same as it was at the beginning, so that "[t]here has been no swelling of the size of [the trustee's] net estate by the use of the trust funds."[145]

The proper analysis compares not the trustee's net worth at the beginning and at the end, but rather the position of the general creditors at the end, with and without the misappropriation. With the misappropriation, and assuming no priority for the trust beneficiary, the $1,000 bond will be split up among the $4,000 in claims, so the general creditors will receive $750 and lose $2,250. The trust beneficiary receives $250 and loses $750.

Now consider the situation without the misappropriation, first assuming that the trustee would have repaid just $1,000 absent the misappropriation. At the end, the trustee will have $1,000 and there will be $4,000 in general claims. Each creditor will be repaid 25%, and the general creditors will lose $3,000. If we assume that $3,000 of the $4,000 are the claims of the creditors who were unpaid in the fraud world, those creditors will lose $2,250, just as in the fraud scenario.

If, however, we assume that the trustee would have repaid $2,000 absent the misappropriation, then at the end, the trustee has $0 and there are $3,000 in general claims, which receive nothing. The unlucky general creditors lose $3,000 instead of $2,250.

143 *See* BOGERT, BOGERT & HESS, *supra* note 136, § 922.

144 *See* Oesterle, *supra* note 115, at 209 (describing standard tracing doctrine's reliance on transactional rather than causal links).

145 BOGERT, BOGERT & HESS, *supra* note 136, § 922.

Put differently, if the misappropriation of $1,000 caused the repayment of $1,000 to the preferred creditors (and there is no preference recovery), then the remaining general creditors do not benefit at distribution from the misappropriation. If, however, the misappropriation caused less than $1,000 of additional repayment then the general creditors will benefit. And a similar analysis of the remaining creditors' position would apply if the trustee simply dissipated the trust funds rather than using them to repay some creditors. Of course, misappropriation may not cause any pre-distribution action that reduces available assets. If the misappropriation induces an increase in profitable investment, then it can benefit the general creditors by more than $1,000.

Professor Daniel Dobbs's comments on the swollen-asset theory are subject to similar remarks.[146] Dobbs writes:

> Payment of debts with the plaintiff's funds does not create wealth in the defendant, much less does payment permit identification of particular property to which a trust or lien could attach. Since no property can be identified, the claim of a trust or lien must rest on a balance sheet assessment that the defendant is wealthier.[147]

He goes on to explain that the payment of other debts either reduces assets and liabilities equally (if the misappropriated property is considered part of the plaintiff's balance sheet) or does not reduce assets at all (if the misappropriated property is not considered part of the plaintiff's balance sheet).[148]

This argument is also misdirected. The reason for embracing the swollen-assets theory would be that the misappropriation, not the repayment, increased the debtor's net worth as of the time of distribution. Dobbs is correct to point out that the subsequent repayment would not reduce the defendant's net worth, but the consequence is that the repayment does not negate the initial enrichment.

Applying the principle against unjust enrichment in an airtight way requires construction of the but-for world absent the fraud, a task that scholars have described as impossible.[149] It may also be impossible to construct the but-for

[146] It is not entirely clear whether Dobbs's commentary is his own criticism of swollen assets or simply explains general criticisms.

[147] DOBBS, *supra* note 36, at 15 n.15.

[148] *See id.*

[149] *See* Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 283 ("The answer is in truth unknowable.").

world absent a breach of contract[150] or absent a non-fraud tort,[151] analytical tasks the law says it demands in other remedial contexts. The difficulty of the ultimate task raises the stakes in choosing a default rule, as it suggests that the default rule will be applied more frequently. The task does not, however, resolve what approach is desirable as a default. When the debtor acquired assets by fraud and the assets are now unidentifiable, modern tracing effectively assumes that the dissipation of assets occurred because of the fraud. The swollen-assets approach presumes that the misappropriated assets still augment the assets available for distribution. It presumes that the lost assets would have been lost absent the fraud. One way of choosing the default rule would be to try to find the assumption that is likely to be closer to the truth in most cases.

This may be difficult, however. In the author's estimation, if a fraudster has gained $1,000, but the $1,000 can no longer be identified and there is no evidence relating to anything else that happened since the fraud, $1,000 typically would be a more reasonable estimate than $0 of the fraudster's enrichment at some later time. But the author has not located empirical evidence directly supporting either this position or the contrary one enshrined in current law. Given the complexity of the problem, it seems unlikely that empirical research will provide a reliable answer to the question in general.

But likely correspondence to a true state of affairs is only one reason for adopting default rules. Default rules also reflect policy considerations.[152] The requirement of proof of criminal guilt beyond a reasonable doubt is a well-known example.[153] Closer to home, when consumer fraud statutes call for disgorgement of profits, strict tracing is often not required.[154] The reason is to

150 *See* RESTATEMENT (SECOND) OF CONTRACTS § 347 (A.L.I. 1981) (causation requirement for contract damages).

151 *See* RESTATEMENT (SECOND) OF TORTS § 431 cmt.a (A.L.I. 1965) (But-for causation of harm is, with one exception for independently operating forces, "necessary, but . . . not of itself sufficient" for negligence liability.)

152 *See, e.g*., Lamps Plus, Inc. v. Varela, 587 U.S. 176, 187 (2019) (describing the contract-law principle of interpretation against the drafter as "a default rule based on public policy considerations").

153 *See In re* Winship, 397 U.S. 358, 363–64 (1970) (describing policy basis for rule); *In re* Winship, 397 U.S. 358, 372 (1970) (Harlan, J., concurring) ("I view the requirement of proof beyond a reasonable doubt in a criminal case as bottomed on a fundamental value determination of our society that it is far worse to convict an innocent man than to let a guilty man go free.").

154 *See, e.g*., FTC v. Bronson Partners, 654 F.3d 359, 373 (2d Cir. 2011) (alteration in original) (quoting SEC v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997)) (holding that in a deceptive advertising case, the FTC was not required to trace funds from consumers to defendant to make use of disgorgement remedy; agency "seeks only to 'deter violations of the [] laws by depriving violators of their ill-gotten gains'"); *see also* FTC v. Commerce Planet, Inc., 815 F.3d 593, 601 (9th Cir. 2016) (not requiring tracing in action arising out of defendant's allegedly deceptive marketing).

discourage misconduct.[155] Similarly, strong commitment to the principles of avoiding profit from wrongdoing and compensating victims would support less restrictive tracing requirements in the present context.

In shifting from tracing to a method more aimed at identifying actual enrichment, there are several ways to estimate the increment in question. Oesterle suggests assuming that "a wrongdoer's creditors benefit from misappropriations that occur within a set time of the satisfaction . . . of the creditors' claims."[156] Another approach would be to presume continuing enrichment in the amount of the misappropriation unless the general creditors can prove otherwise, for example by showing that the debtor lost more money than it otherwise would have because the misappropriation augmented its resources. A third approach would be to compare the value of the debtor at the time of the misappropriation and the time value is assessed for distribution. Fraud claimants would share pro rata in the more likely scenario that value declined. In the less likely scenario that value increased in the interim, the principle against profiting from wrongdoing, combined with the proportionality assumption, seems to suggest that the victim should share in any gains.

The important point is that if fraud priority is based on avoiding unjust enrichment, as most commentators and courts (along with this author) believe it is, the test for whether a fraud victim's claim should get priority should be tailored to measuring actual enrichment due to the fraud. Current tracing law seeks to identify the misappropriated property itself, or other property transactionally linked to it, in the hands of the debtor. But the existence of such property is only fortuitously linked to the debtor's enrichment.

V. IMPLEMENTING EXPANDED FRAUD PRIORITY

To recapitulate, there is a strong normative basis, recognized even in Roman law,[157] that a party should not benefit from wrongdoing at the expense of the victim, even if the party benefiting from the wrongdoing is innocent. Courts generally recognize this principle in bankruptcy by allowing victims of wrongdoing to impress traceable debtor assets with a constructive trust. The requirement of traceability, though firmly established in current law, has a weak connection to what is generally viewed as the underlying normative question:

155 *See Bronson Partners*, 654 F.3d 373.

156 Oesterle, *supra* note 115, at 209.

157 *See* DAWSON, *supra* note 122, at 3 (citing DIG. 50.17.206 (Pomponius, Ex Variis Lectionibus 9)).

whether the wrongdoing to the claimant would actually enrich the general creditors absent some form of priority.

Part V discusses how fraud priority could be expanded. Part V.A compares and contrasts liberalizing constructive trust with enacting statutory priority, arguing that the statutory approach is probably a better solution but that courts should consider more expansive use of constructive trust, given that Congress rarely updates the Code. Part V.B briefly discusses, and rejects, making corporate fraud debts nondischargeable as a potential approach to the problem.

A. Constructive Trust v. Statutory Priority

1. Substantive Aspects

Thus, it is reasonable to ask how the requirement of traceability could be relaxed for fraud claimants. One way of doing so would be to revive the swollen-assets theory in tracing law. Another approach would be for Congress to grant fraud claims a general priority within the bankruptcy scheme.

Statutory priority is probably the best solution. A constructive trust will not be recognized in bankruptcy if it would not be recognized by underlying state law.[158] Therefore, expansion of constructive trust would have to happen in state courts, or possibly in bankruptcy courts applying the law of states that do not explicitly reject the swollen-assets theory. Such change would likely be slow and nonuniform. Moreover, scholars have argued that lawyers' understanding of the law of restitution has been on the decline[159] (although the relatively new

[158] *See, e.g.*, Superintendent of Ins. v. Ochs (*In re* First Cent. Fin. Corp.), 377 F.3d 209, 212 (2d Cir. 2004) (quoting *In re* Howard's Appliance Corp., 874 F.2d 88, 93 (2d Cir. 1989)) (holding that "New York law controls" whether constructive trust will be recognized in bankruptcy case); BBX Operating, L.L.C. v. Bank of Am., N.A. (*In re* Connect Transp., L.L.C.), 825 Fed. App'x 150, 154 (5th Cir. 2020) (rejecting constructive trust where state law would not recognize such a trust); Secure Leverage Grp. v. Bodenstein, 558 B.R. 226, 234 (N.D. Ill. 2016) (finding no resulting trust existed in bankruptcy where state law did not provide for one), *aff'd sub nom.*, *In re* Peregrine Fin. Grp., 866 F.3d 775 (7th Cir. 2017). Although state-law recognition of a constructive trust appears to be a necessary condition for recognition of such a trust in bankruptcy, some courts have indicated that state-law recognition is not a sufficient condition. *See* Torres v. Eastlick (*In re* N. Am. Coin & Currency, Ltd.), 767 F.2d 1573, 1575 (9th Cir. 1985) ("While we agree that any constructive trust that is given effect must be a creature of Arizona law, we cannot accept the proposition that the bankruptcy estate is automatically deprived of any funds that state law might find subject to a constructive trust."); *see also* Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 435 (5th Cir. 1994) (quoting Vineyard v. McKenzie (*In re* Quality Holstein Leasing), 752 F.2d 1009, 1014 n.10 (5th Cir. 1985)) (denying constructive trust, stating that "state law defining property rights may not, of course, go so far as to manipulate bankruptcy priorities.").

[159] *See* Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 267 ("Most law schools gave up teaching restitution a generation ago, and many judges and practitioners are not familiar with its general principles.").

Restatement (Third) of Restitution and Unjust Enrichment may be improving the situation).[160] That lack of understanding could contribute to confused and arbitrary results.

By contrast, the bankruptcy community is thoroughly familiar with claim priority,[161] and adding to the priority scheme would not need to involve state courts. Apart from differences in interpretation, adding such a priority to the Code would create uniformity.

Priority also has the advantage of not requiring special rules for situations where the debtor has defrauded many victims, such as the common case of a Ponzi scheme. Although each victim of a Ponzi scheme would, in isolation, typically be entitled to a constructive trust if it could trace the funds it contributed,[162] courts generally deny such treatment,[163] recognizing that granting it would both violate the equality-is-equity norm[164] and foster the "race to the courthouse" that bankruptcy is designed to prevent.[165] Simply putting all fraud victims on the same priority tier would provide a simpler and more standardized solution to this problem.

Statutory priority is in at least one respect a more flexible instrument than constructive trust. Constructive trust essentially confers a superpriority by

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[160] A Westlaw search on July 27, 2025 in the "Cases" database on "Restatement (Third) of Restitution and Unjust Enrichment" yielded 1,125 hits.

[161] For example, a chapter on "Priority Among Unsecured Creditors" appears early in the popular bankruptcy casebook used by the author. *See* ELIZABETH WARREN ET AL., THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 143–44 (8th ed. 2021).

[162] *See* McAnulty v. Std. Ins., 81 F.4th 1091, 1108–09 (10th Cir. 2023) ("The funds obtained by fraudster through his Ponzi scheme could clearly be subjected to a constructive trust . . . ."); SEC v. Loewenson, 290 F.3d 80, 88 (2d Cir. 2002) (holding that, in a Ponzi scheme case, "[u]nder state law, assets acquired by fraud are subject to a constructive trust for the benefit of the defrauded party").

[163] *See In re* Miss. Valley Livestock, Inc., 745 F.3d 299, 308 (7th Cir. 2014) (holding that, in a Ponzi scheme, "all victims of the fraud may have equivalent claims, thus destroying any particular victim's entitlement to a constructive trust over the entire pool"); *Ramunno*, 599 F.3d at 1274–75 (affirming denial of constructive trust); Hill v. Kinzler (*In re* Foster), 275 F.3d 924, 927–28 (10th Cir. 2001) (remanding to bankruptcy court to determine whether use of lowest intermediate balance rule in Ponzi scheme case was equitable).

[164] *In re Miss. Valley Livestock*, 745 F.3d at 308 (quoting Kull, *Reclamation and Constructive Trust*, *supra* note 56, at 285) (holding that, in a Ponzi scheme, "[b]etween claimants similarly situated, the equities of restitution (like the equities of bankruptcy) favor ratable distribution"); *Ramunno*, 599 F.3d at 1275 ("Fairness does not call for a constructive trust in this case even if [claimant could] trace, because it would elevate his position over that of similarly situated victims."); *Loewenson*, 290 F.3d at 88–89 (upholding pro rata distribution to defrauded parties and stating that "[c]ourts have favored *pro rata* distribution of assets where . . . the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders.").

[165] *See* Henderson v. Allred (*In re* W. World Funding, Inc.), 54 B.R. 470, 474–75 (Bankr. D. Nev. 1985) (citing the avoidance of a "race to the courthouse" as an underlying reason not to allow a preference defendant to defend on the ground that debtor held transferred funds in trust).

removing property from the estate.[166] Statutory priority is more flexible, in that Congress would specify where in the multilevel priority structure fraud claims would fall.[167] Thus, in the statutory approach, fraud claims where proceeds are untraceable need not be given priority over domestic support obligations[168] or administrative claims.[169] If desired, Congress could treat fraud priority differently in chapter 11 reorganization plans than in liquidation, as current law does with certain other priorities.[170]

The drawback to statutory priority as an avenue of reform is that Congress only rarely revises bankruptcy law.[171] Assuming that potential fraud claimants are not a cohesive and politically mobilized group, achieving priority through Congress might be difficult. Thus, it is likely more feasible to approach the problem through judicial expansion of constructive trust.

2. *Procedural Aspects*

Disputes over statutory priority can be handled by a more streamlined procedure than disputes over constructive trust. The difference is between a contested matter and an adversary proceeding.

If a party objects to the priority status of an unsecured claim, the dispute apparently is a contested matter[172] that can be handled by motion.[173] The claim

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166 *See* Secure Leverage Grp. v. Bodenstein (*In re* Peregrin Fin. Grp.), 487 B.R. 498, 515 (Bankr. N.D. Ill. 2013) ("To impose the remedy of a constructive trust for the plaintiffs' claims of fraud or breach of fiduciary duty would effectively grant these creditors a superpriority over all other creditors and even the trustee."); *In re* U.S. Lan Sys. Corp., 235 B.R. 847, 856 (Bankr. E.D. Va. 1998).

167 *See* 11 U.S.C. § 507(a) (setting out ten classes of priority claimants); 11 U.S.C. §§ 364(c)(1), 506(c), 507(b), 726(b) (setting out "superpriorities" for DIP financiers, chargeable trustee expenses of preserving or disposing of property, inadequately protected secured claims, and trustee's chapter 11 expenses when case is converted to chapter 7). At the other extreme, section 726 sets out classes of claims that are subordinated to general claims in liquidation *See* 11 U.S.C. § 726. Section 510(b) subordinates many securities-law claims. *See* 11 U.S.C. § 510(b).

168 *See* 11 U.S.C. § 507(a)(1).

169 *See* 11 U.S.C. § 507(a)(1)(C)–(a)(2).

170 *See* 11 U.S.C. § 1129(a)(9) (specifying treatment of priority claims in a chapter 11 reorganization plan and imposing stricter limits on the treatment of claims specified in sections 507(a)(2) and (a)(3) than of the higher-priority claims specified in section 507(a)(1)).

171 There are some notable recent exceptions, such as the Small Business Reorganization Act of 2019 ("SBRA"), Pub. L. No. 116-54, 133 Stat. 1079, and changes to the Bankruptcy Code in the Coronavirus Aid, Relief, and Economic Security ("CARES") Act of 2020, Pub. L. No. 116-136, § 1113, 134 Stat. 281, 310–12.

172 *See In re* Chamberlain, 555 B.R. 14, 21 (Bankr. D. Colo. 2016) ("Disputes regarding the priority status of a claim . . . are contested matters."); 10 COLLIER ON BANKRUPTCY ¶ 9014.01 (16th ed. 2025) (stating that "an objection to a claim" is a contested matter "unless the objection is joined with a demand of a kind specified in Rule 7001").

173 *See* FED. R. BANKR. P. 9014(a) (requiring a motion for a contested matter).

enjoys a presumption of validity.[174] The objecting party bears the burden of presenting evidence sufficient to rebut the presumption.[175] If the objector does so, the creditor bears the burden of persuasion as to the amount and validity of the claim.[176] Although some opinions state simply that the burden lies with the party claiming priority, these do not address the prima facie validity of the claim.[177]

By contrast, an effort to impose a constructive trust would appear to be one or more of "a proceeding to recover money or property,"[178] "a proceeding to determine the validity . . . of . . . [an] interest in property,"[179] and "a proceeding to obtain . . . equitable relief."[180] Each of these requires an adversary proceeding under Federal Rule of Bankruptcy Procedure 7001.[181]

B. Nondischargeability and State Statutory Liens

1. Nondischargeability

Although nondischargeability is not priority, making more fraud claims against entities nondischargeable in chapter 11 could potentially improve victims' leverage and likely recovery. The idea thus merits at least brief discussion.

As noted, nondischargeability is important to the bankruptcy treatment of fraud claims against individuals but plays only a very limited role in business bankruptcy.[182] In the latter context, nondischargeability is reserved for certain

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174 *See* FED. R. BANKR. P. 3001(f) ("A proof of claim . . . is prima facie evidence of the claim's validity and amount.").

175 *See* Lehman Com. Paper, Inc. v. Palmdale Hills Prop., LLC (*In re* Palmdale Hills Prop., LLC), 423 B.R. 655, 665 (B.A.P. 9th Cir. 2009), *aff'd*, 654 F.3d 868 (9th Cir. 2011).

176 *See In re* Health Trio, Inc., 584 B.R. 342, 348 (Bankr. D. Colo. 2018), *rev'd and remanded on other grounds*, 599 B.R. 119 (D. Colo. 2019).

177 *See* Woburn Assocs. v. Kahn (*In re* Hemingway Transp., Inc.), 954 F.2d 1, 5 (1st Cir. 1992) ("The burden of proving entitlement to priority payment as an administrative expense . . . rests with the party requesting it."); *In re* Fin. Oversight and Mgmt. Bd. for P.R., 631 B.R. 596, 604 (D.P.R. 2021).

178 FED. R. BANKR. P. 7001(a).

179 FED. R. BANKR. P. 7001(b).

180 FED. R. BANKR. P. 7001(g).

181 *See* Vanco Trading, Inc. v. Monheit (*In re* K Chem. Corp.), 188 B.R. 89, 98 (Bankr. D. Conn. 1995) (finding that action to impress constructive trust falls into all three categories); *In re* Crockett, 642 B.R. 97, 103 (Bankr. D. Conn. 2022) (quoting and following *K Chemical Corp.*).

182 *See* discussion *supra* Part I.A.

claims arising from fraud against the government or tax evasion.[183] Section 1141(d)(6) of the Code provides for this limited nondischargeability.[184]

Section 1141(d)(6) was adopted in the Bankruptcy Abuse and Consumer Protection Act of 2005.[185] A predecessor bill contained a much broader version of the provision, one that would have covered "any debt described in section 523(a)(2)" (that is, any fraud debt that an individual could not discharge).[186]

Such a provision would have moved the nondischargeability of corporate fraud debts closer to that which existed under Chapter XI of the Bankruptcy Act of 1898, as amended by the Chandler Act of 1938. The Chandler Act excepted from discharge "such debts as . . . are not dischargeable" in an individual case.[187] As Professor Ralph Brubaker explains, this broad dischargeability invited last-minute nondischargeability actions by holdout creditors that derailed reorganizations, a phenomenon that figured into Congress's decision in 1978 to do away with business-entity nondischargeability in the new Code.[188]

Brubaker argues convincingly that nondischargeability does not make sense for business entities.[189] As he explains, the chapter 11 discharge for business entities is not designed to give the entity a "fresh start."[190] Rather, the discharge just carries out the substitution of a new capital structure for the old one.[191] Moreover, a business entity can avoid nondischargeability by selling its assets free and clear of obligations.[192] In short, the main reason for nondischargeability does not apply in the context of entity reorganization,[193] and nondischargeability seems likely to be relatively ineffective in increasing fraud victims' leverage.

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[183] *See* discussion *supra* Part I.A.

[184] *See* discussion *supra* Part I.A.

[185] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 708, 119 Stat. 23, 126 (2005).

[186] H.R. REP. NO. 106-970, § 708, at 96 (2000).

[187] The Chandler Act of 1938, Pub. L. No. 75-696, § 371, 52 Stat. 840, 912. The 1898 Act, as amended by the Chandler Act of 1938, provided another chapter under which corporations could reorganize, Chapter X, which did provide for dischargeability of all but priority tax debts. *See* Chandler Act of 1938, Pub. L. No. 75-696, § 271, 52 Stat. 840, 904. Despite the broader discharge available under Chapter X, Chapter XI "evolved into the dominant reorganization vehicle." *See* Ralph Brubaker, *Taking Exception to the New Corporate Discharge Exceptions*, 13 AM. BANKR. INST. L. REV. 757, 763 (2005) (quoting COMM'N ON THE BANKR. L. OF THE U.S., REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 246 (1974)).

[188] *See* Brubaker, *supra* note 187, at 765–66.

[189] *See id*. at 759–60.

[190] *See id.* at 759–62.

[191] *See id*. at 761.

[192] *See id*. at 770.

[193] *See id*. at 765 (writing of Section 1141(d)(6), "[t]hat which is cast as curbing debtor abuse primarily impacts the readjustment of the relative rights of creditors *inter se*").

2. *State Statutory Liens*

Another approach to vindicating the interests of fraud claimants would be to grant such claimants statutory liens under state law. Because state legislatures would enact these liens, this approach could work despite congressional inertia. However, unlike the constructive-trust approach, the statutory-lien approach apparently could not be pursued by courts under current law: the author's research has not uncovered any existing state statutory liens in favor of fraud victims or involuntary creditors generally.[194]

VI. ANSWERING OBJECTIONS TO EXPANDING FRAUD PRIORITY

Part VI addresses objections to expanding fraud priority. Part VI.A argues that objections to fraud priority based on the principle that "equality is equity" are misplaced, given that fraud claimants are not similarly situated to general unsecured creditors. Part VI.B contends that any threat to the stability of property rights from expanding fraud priority is limited. Part VI.C argues that, although the Article has no quarrel with proponents of granting priority to all involuntary creditors, fraud claimants are not similarly situated to many other involuntary creditors because the wrongdoing to fraud creditors has enriched the estate. Part VI.D argues that priority for fraud claims poses only a limited risk to reorganization. Part VI.E rejects the contention that priority for fraud claims will invite an unmanageable volume of frivolous litigation.

A. *Equality Is Equity Only for Similarly Situated Claimants*

A principal objection, raised by both scholars[195] and some courts,[196] to priority for fraud victims is that priority would interfere with bankruptcy's

[194] California provides that criminal restitution orders may be enforced "as if the restitution order were a civil judgment, and enforceable in the same manner as is provided for the enforcement of any other money judgment." CAL. PENAL CODE § 1214(b) (West 2026). This provision does not appear to place fraud claimants on a stronger footing than other holders of civil judgments. Federal admiralty law does provide for a "preferred maritime lien," with priority over a ship mortgage, "for damage arising out of a maritime tort," 46 U.S.C. § 31301(5)(B); *see also* Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1907 n.86 (1994) (discussing this provision). Government involuntary creditors enjoy statutory liens in some settings relating to environmental remediation. *See, e.g.*, 42 U.S.C. § 9607(1) (lien in favor of United States for remediation costs for Superfund sites); CAL. HEALTH & SAFETY CODE § 115205(a) (West 2026) (lien in favor of California for certain costs of remediating radioactive contamination).

[195] *See* Sherwin, *supra* note 42, at 327 ("The only general principle that appears regularly in the cases is the maxim that equality is equity in bankruptcy."). Sherwin argues that this is an inadequate standard because equality is not always the norm and because it would prohibit recognition of any constructive trusts in bankruptcy. *See id.*

[196] *See, e.g.*, Flanagan v. Mangan (*In re* Flanagan), 503 F.3d 171, 182 (2d Cir. 2007); Superintendent of Ins. v. Ochs (*In re* First Cent. Fin. Corp.), 377 F.3d 209, 217 (2d Cir. 2004) (alteration in original) (quoting Haber

general policy of equal treatment of similarly situated creditors. A positive-law rejoinder is that nothing specific in the Code forbids recognition of constructive trusts, constructive trusts generally are recognized at state law,[197] and bankruptcy law generally takes state-law entitlements as it finds them.[198] Thus, the Courts of Appeals in all circuits, with the possible exception of the Sixth Circuit, recognize that constructive trusts can be imposed in bankruptcy.[199]

The appeal to equality of distribution may serve as a higher-level policy argument. Perhaps the equality norm is a federal bankruptcy interest that justifies a departure from recognizing state-law rights.[200] But one may question just how seriously bankruptcy law takes the norm of equality. A complex system of priorities, some arguably reflecting the political power of special interests,[201] already causes the system to depart from the equality idea.[202] The bankruptcy system also tolerates several common ways of evading the equality norm apart from the priorities set forth in the statute, as Professor David Skeel has recently explained.[203]

In any event, the idea that "equality is equity" applies only to similarly situated claims.[204] As argued above, fraud victims that should enjoy priority are

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Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 436 (5th Cir. 1994)) (stating that constructive trust "can wreak . . . havoc with the priority system ordained by the Bankruptcy Code"); XL/Datacomp, Inc. v. Wilson (*In re* Omegas Grp.), 16 F.3d 1443, 1449–50 (6th Cir. 1994); Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 436 (5th Cir. 1994).

197 *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55 cmt. b (A.L.I. 2011) ("Constructive trust . . . originat[es] in equity, but [is] in widespread current usage . . . .").

198 *See* Butner v. United States, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

199 *See* discussion *supra* Part I.B.

200 *See Butner*, 440 U.S. at 55 (state-law property interests to be respected "unless some federal interest requires a different result").

201 *See, e.g.*, Lester Brickman & Jonathan Klein, *The Use of Advance Fee Attorney Retainer Agreements in Bankruptcy: Another Special Law for Lawyers?*, 43 S.C. L. REV. 1037, 1045 n.31 (1992) (arguing that political stature of Robert Dole of the grain-producing state of Kansas was influential in gaining priority status for grain producers' claims).

202 *See supra* note 167 (discussing bankruptcy's statutory priority scheme).

203 *See* David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors"*, 166 U. PA. L. REV. 699, 714–20 (2018) (explaining how debtors can: (1) evade the preference provision; (2) use the executory-contract rules to favor particular creditors; (3) designate favored creditors as "critical vendors"; (4) incorporate favored treatment into a sale; and (5) favor creditors in the reorganization plan through gifting provisions or separate classification of creditors; and concluding "the equality of creditors norm seems to be on the verge of disappearing altogether")*; see also* Melissa B. Jacoby, *Unbundling Business Bankruptcy Law*, 101 N.C. L. REV. 1703, 1715–17 (2023) (discussing evasion of equality norm).

204 Although courts have more commonly stated this principle explicitly in cases of receivership, the idea holds in bankruptcy as well. *See* SEC v. Wealth Mgmt. LLC, 628 F.3d 323, 333 (7th Cir. 2010); SEC v. Malek, 397 Fed. App'x 711, 716 (2d Cir. 2010); Quilling v. Trade Partners, 572 F.3d 293, 298 (6th Cir. 2009). The idea

not similarly situated to general unsecured creditors, because the former group consists of victims of wrongdoing whose victimization has enriched the estate.[205]

B. Fraud Claim Priority Poses at Most Limited Risk to Stability of Property Rights

Professor Emily Sherwin came to the view that priority for claimants who involuntarily enrich the estate unacceptably undermines the stability of property.[206] Reasonable minds can differ on how much damage priority status for fraud victims really does to the stability of property interests. Notably, Sherwin finds the threat to determinacy relatively small in at least some fraud cases, writing, "[A] claimant who transferred property on the strength of an intentional misrepresentation has a reasonably predictable right to rescind, and so might likewise be viewed as the effective owner of the property at stake."[207]

Creditors who rely on a counterparty's balance sheet in deciding to extend credit[208] may expect that the reported assets will be available to satisfy their claims, but they already contend with the priority of tax[209] and bankruptcy administrative claims,[210] to name two important examples. One hopes that fraud is not so prevalent that granting such claims priority materially changes the picture. Moreover, as discussed, victims of wrongdoing who have enriched the estate are at least arguably more deserving of protection than involuntary claimants as a group.[211]

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also holds in forfeiture. United States v. Wilson, 659 F.3d 947, 956 (9th Cir. 2011); Cunningham v. Brown, 265 U.S. 1, 13 (1924) (invoking maxim that "equality is equity" where "the victims of Ponzi were not to be divided into two classes"); Distral Energy Corp. v. Mich. Boiler & Eng'g Co., 171 B.R. 565, 576 (Bankr. E.D. Mich. 1993).

205 *See* discussion *supra* Part III.B.

206 *See Why* In Re Omegas Group *Was Right*, *supra* note 69, at 898.

207 *Unjust Enrichment*, *supra* note 69, at 148. Sherwin distinguishes cases presenting this type of restitutionary claim from the "many cases" in which "'equitable' ownership is not governed by determinate rules," such as cases of mistaken improvement, undue influence, and restitution between unmarried cohabitants. *Unjust Enrichment*, *supra* note 69, at 148–50.

208 Sherwin noted in 1989, "Normally, unsecured creditors do not rely on specific assets in extending credit to the debtor, because they have no assurance that those assets will be available in the debtor defaults." Sherwin, *supra* note 42, at 360. Reliance even on the debtor's asset-liability picture as a whole seems to be in decline, as evidenced by the increasing prevalence of cash-flow covenants over balance-sheet covenants over the last two decades. *See* Frederick Tung, *Do Lenders Still Monitor? Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 153, 158–59 (2021).

209 *See* 11 U.S.C. § 507(a)(8).

210 *See* 11 U.S.C. § 507(a)(1)(C)–(a)(2).

211 Sherwin argues that some fraud victims should be understood as having assumed the risk of being defrauded, so that their claims are not "involuntary," as she would require for constructive trust. *See* Sherwin, *supra* note 42, at 351 ("To determine whether other creditors will be unjustly enriched by sharing in the property

C. *Fraud Victims Are Not Similarly Situated to Many Other Involuntary Creditors*

Professor Hanoch Dagan argues that there is no meaningful distinction between victims of wrongdoing whose victimization enriches the estate (e.g., fraud victims) and victims of wrongdoing whose victimization does not enrich the estate (e.g., prototypical tort victims).[212] Importantly, Dagan's argument supports priority for fraud claimants, although it would extend priority to other tort claimants as well. This Article has no quarrel with Dagan's call for priority for all tort victims.[213] However, torts that enrich the estate, such as the fraud claims under discussion here, can be distinguished from torts that do not. In the former case, general creditors gain because of the victims' loss. Denying priority allows the general creditors to profit from the debtor's wrongdoing at the victim's expense. That is not true of torts that simply harm the victim.

Moreover, this Article argues that fraud victims have a particularly strong normative claim because they are victims of intentional wrongdoing. Previous writers have assumed that the normative foundation, if any, of the fraud victim's claim as against general creditors[214] must be that the fraud induced an "involuntary" transfer to the debtor.[215] In so doing, they have ignored, or

at issue, the court must consider the degree to which the claimant chose to deal with the debtor, understanding that she ran a risk of loss through the debtor's misconduct and insolvency."). This comes close to a comparative-fault framework for fraud. It is at least arguably inappropriate to be too exacting in scrutinizing the fault of victims of wrongdoing. *See* RESTATEMENT (SECOND) OF CONTRACTS § 172 (A.L.I. 1981) (fault of the recipient of a misrepresentation "does not his make reliance unjustified unless it amounts to a failure to act in good faith and in accordance with the reasonable standards of fair dealing"); RESTATEMENT (SECOND) OF CONTRACTS § 172 cmt. a (A.L.I. 1981) (lack of good faith applies only in "extreme cases"); RESTATEMENT (SECOND) OF CONTRACTS § 172 cmt b. (A.L.I. 1981) ("fraudulent or innocent" character is misrepresentation-relevant in assessing reasonableness of reliance).

212 *See* Dagan, *supra* note 84, at 274 ("[T]he only justification for the imposition of constructive trusts that survives normative scrutiny is the idea that involuntary creditors should not be pooled together with voluntary ones.'); Hanoch Dagan, *Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred*, 78 AM. BANKR. L.J. 247, 274 (2004) ("The traditional doctrine . . . is . . . disappointing as it indefensibly privileges restitution claimants over garden-variety tort victims.").

213 For a recent argument for tort-claim priority, see Luke Sperduto, *Three and a Half Rules for Tort Claims in (and out of) Chapter 11*, 95 AM. BANKR. L.J. 127 (2021). For a classic work on the subject, see Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 864–65 (1996) (arguing that secured creditors' full priority over "nonadjusting" creditors such as tort creditors has both distributional effects and efficiency costs).

214 Sherwin does note that constructive trust can serve the purpose of deterring wrongful conduct when the debtor, rather than the creditors, is the party who loses due to imposition of the trust. This would be the case, for example, when a constructive trust is imposed on homestead property. Sherwin, *supra* note 42, at 343–44.

215 *See* Kull, *supra* note 56, at 282 (certain restitution claimants "prevail[] over the creditors because, unlike them, he has not consented to be a creditor of the debtor," so that distribution of proceeds of transaction "would therefore result in an involuntary transfer, accomplished in two stages, from claimant to creditors"); Dagan, *supra* note 84, at 274 ("[T]he only justification for the imposition of constructive trusts that survives normative

dismissed without explanation,[216] the possibility that fraud victims might have a stronger claim than other "involuntary" creditors that have enriched the estate precisely because fraud is a wrong.

D. Fraud Claim Priority's Interference with Reorganization Is Limited

In addition to the distributional issues that priority for fraud claims raises, there is also an efficiency issue: recognizing priority arguably could make it more difficult to reorganize in bankruptcy. Because fraud claims do not enjoy statutory priority,[217] the debtor enjoys considerable flexibility in dealing with such claims when a constructive trust is not imposed. A chapter 11 plan of reorganization presently can promise holders of such fraud claims less than the allowed amount of the claim, even when general unsecured creditors are promised a recovery.

If fraud claims were granted statutory priority, the debtor's freedom of action would be reduced. The requirements for treatment of priority claims in chapter 11 depend on whether the class including the claims accepts or rejects the plan.[218] If the class rejects the plan, the plan must provide full cash payment of the priority claims on the effective date of the plan confirmation.[219] If the class accepts the plan, the priority claims can be paid over time in an amount with a present value equal to the allowed amount of the claim.[220] Constructive trust takes the property in question out of the estate entirely.[221]

Expanding priority, either by adding to statutory priority or expanding constructive trust could create situations where the debtor's going-concern value

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scrutiny is the idea that involuntary creditors should not be pooled together with voluntary ones."); ROTHERHAM, *supra* note 81, at 86 ("paradigm case" for priority involves a creditor who has "involuntarily enriched" the estate); Sherwin, *supra* note 42, at 350–55 (analyzing whether fraud claimant should be able to impress a constructive trust in terms of "[t]he characterization of [the] fraud claimant as a voluntary or involuntary creditor" without mentioning debtor's culpability). Given that the victim knowingly and intentionally transfers property to the perpetrator in many frauds, the "involuntariness" rationale requires adoption of a particular view of what is a "voluntary," as opposed to an "involuntary," transfer.

216 Sherwin, *supra* note 42, at 358 (regarding transfers by mistake: "At first glance, the absence of wrongdoing may appear to weaken the plaintiff's case for priority . . . [b]ut . . . the innocence of the recipient should not affect the question of priority in bankruptcy.").

217 *See* discussion *supra* Part I.A.

218 Exceptions to this general treatment exist for administrative and tax claims. Administrative claims must be paid in full in cash on the effective date of the plan. *See* 11 U.S.C. § 1129(a)(9)(A). Priority tax claims must be paid the present value of the claim over five years or less and "in a manner not less favorable than the most favorable nonpriority unsecured claim provided for by the plan." 11 U.S.C. § 1129(a)(9)(C).

219 *See* 11 U.S.C. § 1129(a)(9)(B)(ii).

220 *See* 11 U.S.C. § 1129(a)(9)(B)(i).

221 *See* discussion *supra* Part I.B.

simply is not sufficient to cover the expanded class of priority claims.[222] This could frustrate an otherwise-valid reorganization.

To be sure, an individual priority claimant can waive the entitlement to full payment.[223] However, the existence of the entitlement could create a "holdout" problem, where some fraud claimants simply refuse to compromise.[224]

One answer—bolstered by the observation that reorganization is not an end in itself[225]—is simply to observe that tradeoffs are inevitable. If priority for fraud victims is a normatively superior outcome, then a tradeoff with reorganization viability may be worth making.

Another potential answer would be to grant statutory priority and permit a majority of fraud claimants to bind dissenters. Fraud claimants would be classified separately and would vote on the plan with the same rules as other classes.[226] If the plan promised to the fraud claimant class payments with a present value less than the allowed amount of the claim, plan approval by the fraud-claimant class would be a confirmation requirement.[227] This approach would provide some flexibility in the treatment of fraud claims, and the fraud claimants' veto power presumably would produce better treatment for them than for other creditors.[228]

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[222] *Cf.* Ralph Brubaker, Anthony J. Casey, Susan M. Freeman & Bruce A. Markell, *Corporate Panel—Chapter 11 Cramdown Interest Rates: Till, Momentive, and the Proper Valuation Method*, 32 EMORY BANKR. DEV. J. 425, 442 (2017) (remarks of Prof. Brubaker) ("[W]hat bankruptcy is all about is how to allocate that going concern value.").

[223] *See* 11 U.S.C. § 1129(a)(9) (providing that distribution requirements for priority creditors apply "[e]xcept to the extent that the holder of a particular claim has agreed to a different treatment of such claim").

[224] *See, e.g.*, Harrington v. Purdue Pharma, L.P., 603 U.S. 204, 233 (2024) (Kavanaugh, J., dissenting) ("To address any collective-action or holdout problem, the bankruptcy court has the power to approve a reorganization plan even without the consent of every creditor.").

[225] *See* Melissa Jacoby, *Fake and Real People in Bankruptcy*, 39 EMORY BANKR. DEV. J. 497, 505 (2023) ("There is nothing inherently preferable about reorganization of a fake person over its liquidation. The objectives are instrumental.").

[226] *See, e.g.*, 11 U.S.C. § 1126(c) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . .that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by [holders of such interest].").

[227] *See* 11 U.S.C. §§ 1126(c), 1129(a) (setting forth confirmation requirements for chapter 11 reorganization plan).

[228] *See, e.g.*, Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion - A Response to Skeel*, 130 YALE L.J. F. 335, 343 (2020) (stating that, in bankruptcy, "the creditors negotiate in the shadow of liquidation or their cramdown entitlement").

E. Expanded Priority Should Not Induce Large Numbers of Invalid Fraud Claims

Giving priority status to fraud claims could lead creditors to recast contract claims as fraud claims, as the Court of Appeals for the Fifth Circuit observed in *Haber Oil*.[229] After all, it is easy enough to assert that a debtor never intended to perform a contractual obligation such as repaying a debt, supplying the scienter element of fraud.[230] But the system already contains incentives to claim fraud and functions nonetheless. In the individual context, fraud claims are nondischargeable, so creditors have an incentive to characterize their claims in this way. And although fraud nondischargeability produces a considerable amount of litigation, the system continues to work, dealing with 481,350 nonbusiness filings in 2024.[231]

One reason to think that giving priority to fraud claims would not break the bankruptcy system is that the bankruptcy rules already imposed a heightened pleading standard on fraud claims: as in ordinary civil litigation, the party alleging fraud must "state with particularity the circumstances constituting fraud."[232] If anything, the trend appears to be toward more demanding application of pleading requirements in general.[233]

CONCLUSION

The debate over priority for fraud claims in bankruptcy has taken place mostly in the context of constructive trust, which provides a form of priority for fraud claims by earmarking specific property the debtor gained through fraud

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229 *See* Haber Oil Co. v. Swinehart (*In re* Haber Oil Co.), 12 F.3d 426, 436 (5th Cir. 1994).

230 *See* RESTATEMENT (SECOND) OF TORTS, § 530 cmt. c (A.L.I. 1976) ("Since a promise necessarily carries with it the implied assertion of an intention to perform it follows that a promise made without such an intention is fraudulent and actionable in deceit . . . ."); COLLIER ON BANKRUPTCY, *supra* note 28, ¶ 523.08[d] ("[S]ection 523(a)(2)(A) [false pretenses of representations] may make a creditor's claim nondischargeable if the debtor had no intention of performing any of the obligations under the contract."); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 171 cmt. b (1981) ("If . . .the promise is made with the intention of not performing it, [the] implied assertion [of intent to perform] is false and is a misrepresentation.").

231 *See* U.S. SUP. CT., 2024 YEAR END REPORT OF THE FEDERAL JUDICIARY 14 (2024), https://www.supremecourt.gov/publicinfo/year-end/2024year-endreport.pdf.

232 Fed. R. Civ. P. 9(b) (2024) (adopted in full by FED. R. BANKR. P. 7009 (2025)). The rule does provide that "[m]alice, intent, knowledge, and other conditions of person's mind may be alleged generally." Fed. R. Civ. P. 9(b) (2024) (adopted in full by FED. R. BANKR. P. 7009 (2025)).

233 Although the required mental state may be alleged generally, the complaint as a whole must "state a claim to relief that is plausible on its face," which the Supreme Court has held "asks for more than a sheer possibility that a defendant has acted unlawfully" and is not satisfied by pleading facts that are "merely consistent with" liability. Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 557 (2007)).

(and its products and proceeds) and removing the property from the bankruptcy estate. The ultimate normative justification for priority through this vehicle is generally said to be avoiding unjust enrichment. Most courts recognize the availability of constructive trusts in bankruptcy, but the doctrine of constructive trust limits recovery to "traceable" property.

This Article presents a normative argument for priority based on unjust enrichment. It describes fraud-based enrichment as unjust because deception is wrong, rather than only because fraud-induced transfers are involuntary. The Article also pursues the logic of unjust enrichment to its conclusion. That is, fraud priority in bankruptcy should be designed to avoid the possibility that general creditors will profit from fraud, rather than contingent on whether the claimant can identify the specific misappropriated property or its proceeds or products.

The law of constructive trust actually once contained the tools to elevate the status of fraud claimants along the lines this Article recommends. The once-popular swollen-assets theory, which has now fallen into disuse, presumes that fraudulently acquired assets continue to enrich the fraudster unless otherwise proven and relieves the claimant of the burden of showing continued enrichment. Reviving the swollen-assets theory would go a long way toward giving fraud claimants priority. Although statutory priority for fraud claimants would be a cleaner solution that fits more easily into bankruptcy law as a whole, questions about the viability of reform through Congress suggest that courts should consider an approach that can be accomplished without legislation.