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Exceptions to Discharge

- SCOTUS Wades Into Area of Bankruptcy ‘Confusion’

BNA Snapshot

• U.S. Supreme Court will resolve circuit split on bankruptcy discharge issue.

• Case most likely will be argued in April, with a decision before end of term in June.

By Diane Davis

The U.S. Supreme Court will wade into a matter of “substantial disagreement” and “confusion” when it tackles the question of how much weight bankruptcy courts should give a statement made by debtors about a single aspect of their finances that's not in writing.

The justices agreed Jan. 12 to take up Lamar, Archer & Cofrin, LLP v. Appling, which is a case about a businessman who made a false statement to the law firm about using his anticipated tax refund to receive an extension of credit on services that he hoped to continue receiving.

The bankruptcy and district court found that it wasn't a statement respecting, or reflecting, the debtor's financial condition. But the Eleventh Circuit disagreed and allowed R. Scott Appling to discharge or wipe out in bankruptcy more than $100,000 in legal fees to Lamar, Archer & Cofrin, LLP.

Typically, a debtor can't discharge any debt incurred by fraud. But as long as the false statement isn't in writing, a debtor can discharge a debt incurred by a false statement respecting his financial condition.

The answer to the question whether a statement about a single asset can be a “statement respecting the debtor's financial condition” within the meaning of Bankruptcy Code Section 523(a)(2)(B) matters because “even a fraudulent statement respecting the debtor's financial condition is dischargeable unless made in writing,” Charles J. Tabb, of counsel, Foley & Lardner LLP, and Mildred Van Voorhis Jones Chair in Law at the University of Illinois in Champaign, Ill., told Bloomberg Law Jan. 16.

There's a “lot of confusion among the courts about the meaning of the two alternative grounds for nondischargeability of a debt obtained by some kind of false pretense or false representation,” Juliet M. Moringiello, a business law professor at Widener University Commonwealth Law School, Harrisburg, Pa., told Bloomberg Law Jan. 17. So, a Supreme Court opinion is “most welcome,” she said.

This is the third bankruptcy case of the term and will most likely be argued in April, with a decision

rendered by the end of the court's term in June.

Circuit Split

This question arises "with some frequency" and has been the subject of "substantial disagreement among the lower federal courts," the Department of Justice's U.S. solicitor general said in its amicus "friend of the court" brief urging the court to hear the case.

Here, the U.S. Court of Appeals for the Eleventh Circuit reversed a federal district court, which had sided with the bankruptcy judge in ruling against Appling.

The Eleventh Circuit held that a fraudulent statement about even a single asset indeed can be wiped out in bankruptcy unless made in writing. That decision led to the Supreme Court appeal by Lamar, Archer & Cofrin.

Other courts, including the Fifth, Eighth, and Tenth circuits, conclude that only statements about the debtor's entire financial condition must be made in writing.

"Courts in the camp that would exclude from discharge debts arising from an oral statement about only part of a debtor's financial condition are motivated in part by an intuition and moral revulsion at letting a dishonest debtor discharge the fraud debt," Tabb said.

The Eleventh Circuit "got it right," Tabb said, "but if the Supreme Court reverses, it will be because they have a strong aversion to letting dishonest debtors discharge debts no matter what the statute says."

Appling is a "very unsympathetic figure," he said.

The "irony," according to Tabb, is that "if you're a fraudster, you're better off if you lie orally about all of your finances because then you certainly get a discharge."

Reversal of the Eleventh Circuit would "further weaken the fresh start" of bankruptcy, and "rewrite the Code that Congress enacted," Tabb said.

Uniformity Needed

Uniformity in law, especially in bankruptcy, is essential to prevent forum shopping.

"Discharge is a creature of federal bankruptcy law and thus courts across the nation should interpret the standards for non-dischargeability uniformly," Moringiello said.

Bankruptcy law "tolerates a lot of non-uniformity when property rights are involved because property rights are defined in the first instance by state law and are modified only when some federal (bankruptcy) interest requires modification," she said. "But there is no state law discharge of debts without consent of the creditor—only bankruptcy law can do that," Moringiello said.

When it hears the case, the court will be interpreting Bankruptcy Code Sections 523(a)(2)(A) and (a)(2)(B).

Under Section 523(a)(2)(A), a debt won't be discharged if it resulted from a "false representation, or

actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

Section 523(a)(2)(B) provides that a debt won't be discharged if it resulted from a materially false written statement "respecting the debtor's … financial condition."

The Eleventh Circuit gave Section 523(a)(2) a broad reading when it concluded that a statement respecting the debtor's financial condition may include a statement about a single asset, and allowed Appling to discharge the legal fees in bankruptcy.

That decision is wrong, law firm Lamar, Archer & Cofrin LLP, argued in its petition.

The Eleventh Circuit's interpretation fails to follow the text of Section 523(a)(2)(A), the law firm said.

"Financial condition" is different than "finances" generally, they said, and when the Bankruptcy Code uses the term "financial condition," it refers to the debtor's financial health generally.

The Eleventh Circuit's decision followed the plain meaning of the statutory text, the legislative purpose, and the statute's history, according to Appling's brief in opposition.

Appling's interpretation of the statute encourages creditors to rely on written statements, which furthers accuracy and predictability in bankruptcy proceedings, he said.

"If a creditor wishes to rely on a statement respecting the debtor's finances as a basis to later seek an exemption from bankruptcy discharge, that statement must be made in writing. Then if a debtor declares bankruptcy years (or decades) later, there can be no dispute as to the content of the statement itself," Appling said in its brief.

While the Department of Justice agreed with Lamar, Archer & Cofrin that the court should review the case, it believes the Eleventh Circuit's judgment should be affirmed.

Latham & Watkins LLP, Washington, represents Lamar, Archer & Cofrin LLP; Mayer Brown LLP, Washington, represents Appling.

The case is Lamar, Archer & Cofrin, LLP v. R. Scott Appling , U.S., No. 16-1215, review granted, 1/12/18.

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