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Exceptions to Discharge

‘Dishonest Debtor’ Prevails Over Law Firm at Supreme Court (1)

BNA Snapshot

- Businessman who promised to pay lawyers but didn't can wipe out debt in Chapter 7
- Decision resolves split among circuit courts

By Diane Davis

A businessman who reneged on an oral promise to pay his attorneys and then was permitted to wipe out that debt in bankruptcy beat back a challenge June 4 at the U.S. Supreme Court from the law firm seeking to get its money.

Scott Appling's promise that he could only pay his debt with a tax refund amounted to a statement about a single asset that reflected, or represented, his overall financial condition and was eligible for discharge, Justice Sonia Sotomayor wrote for a unanimous court.

“This is a case about what constitutes a ‘statement respecting the debtor's financial condition’” in bankruptcy, Sotomayor said in affirming the U.S. Court of Appeals for the Eleventh Circuit, which had split from the Fifth, Eighth, and Tenth circuits.

Although it ruled narrowly, the case is “significant in a larger sense because the court rejected the invitation to read the Bankruptcy Code so that a dishonest debtor always loses, no matter what the statute appears to say,” Charles J. Tabb, of counsel with Foley & Lardner LLP, told Bloomberg Law.

“In the context of the fraud exception, financial condition fraud is excluded from discharge only if made in writing,” he said. “It is heartening that the court was willing—and unanimously so—to apply the statute as written to let even a dishonest debtor discharge his debts,” Tabb said.

Juliet M. Moringiello, a business law professor at Widener University Commonwealth Law School in Harrisburg, Pa., said the decision also permits courts to avoid drawing lines.

“It would have made little sense for the court to say that a statement about one asset is not a ‘statement respecting the debtor's financial condition,” Moringiello said. “What about 2 or 3 assets?” she asked.

“So this seems right,” Moringiello said.

Orally Promised to Pay

Bankruptcy Code Section 523(a)(2) prohibits debtors from discharging debts for money, property, services, or credit obtained by “false pretenses, a false representation, or actual fraud,” or, if made in writing, by a materially false “statement … respecting the debtor's … financial condition.”

Appling owed Lamar, Archer & Cofrin more than $60,000 in legal fees for representing him in litigation, and verbally promised to pay the bill with his refund, but later failed to do so. He spent the money on business expenses, the court said.

Appling later tried to discharge a $104,000 state court judgment in Chapter 7, but the bankruptcy and district court judges said his oral statement about a single asset, the tax refund, didn't respect his overall financial condition and couldn't be discharged.

The Eleventh Circuit went the other way and allowed him to wipe out the fees. The Supreme Court heard oral arguments April 17 during which the justices appeared skeptical of the petitioner's reading of the text, Danielle D'Onfro, a lecturer at Washington University School of Law in St. Louis told Bloomberg Law.

The firm's “interpretation of the word ‘respecting’ was unreasonably narrow to make sense from a plain usage perspective,” she said after the decision. “It was even less effective here because the court had previously expressed that ‘respecting’ has the same meaning as the phrase ‘relating to,’ which the court has consistently interpreted broadly.”

Plain Language Prevails

To determine whether a statement about a single asset like a tax return qualified as a “statement respecting the debtor's financial condition,” Sotomayor looked at the plain language of Section 523(a)(2) and used ordinary meanings of words to define words that aren't defined in the Bankruptcy Code.

The key word in the statutory phrase is “respecting,” which joins together “statement” and “financial condition,” she said.

Lamar wanted to define the words broadly, but the court rejected that interpretation.

The court agreed with Appling and the government, as amicus curiae friend of the court, that a statement is “respecting” a debtor's financial condition if it “has a direct relation to or impact on the debtor's overall financial status.”

“Naturally, then, a statement about a single asset can be a ‘statement respecting the debtor's financial condition,’” Sotomayor said.

Lamar's interpretation “would yield incoherent results,” she said.

The statutory history of the phrase “statement respecting the debtor's financial condition” also corroborates this reading of the text, Sotomayor said.

Moringiello found the court's “long discussion of the meaning of the word ‘respecting’ a little bit bizarre” because she believed the key to the case was the meaning of “financial condition,” not “respecting.”

No ‘Shield for Dishonest Debtors’

If Lamar Archer & Cofrin had asked Appling to write down his representation about his expected tax refund, “they could have blocked the discharge of his debt to them,” Tabb said.

“Writings can foster accuracy at the outset of a transaction, reduce the incidence of fraud, and facilitate the more predictable, fair, and efficient resolution of any subsequent dispute,” Sotomayor said.

Justices Clarence Thomas, Samuel A. Alito, Jr., and Neil M. Gorsuch joined the opinion, except for Part III-B, which discussed the legislative history behind the provisions in the case.

“Occasionally, Justice Thomas will write separately to express this skepticism, but his position on this front is so well known that writing separately hardly seems necessary,” D'Onfro said. Justice Gorsuch appears “inclined to do the same,” she said.

Gregory G. Garre, Latham & Watkins LLP, Washington, represented Lamar, Archer & Cofrin; Paul W. Hughes, Mayer Brown LLP, Washington, represented Appling; Jeffrey E. Sandberg represented the United States as amicus curiae.

The case is *Lamar, Archer & Cofrin, LLP v. Appling* , U.S., 16-1215, 6/4/18.

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