

# The Supreme Court Extends Bankruptcy Protections To Even Dishonest Debtors

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# **The Supreme Court Extends Bankruptcy Protections To Even Dishonest Debtors**

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Can an individual debtor make an oral false statement about an asset to a creditor and get away with it by discharging the creditor's claim in his or her bankruptcy? On June 4, 2018, the Supreme Court issued its opinion in *Lamar, Archer & Cofrin, LLP v. Appling* in which the Court unanimously answered this question in the affirmative.

The facts of the case are relatively straightforward. The law firm of Lamar, Archer & Cofrin, LLP (the "Firm") represented R. Scott Appling ("Appling") in business litigation. Appling fell behind in payment of his legal bills, and the Firm threatened to withdraw as his counsel and to place a lien on its work product until it was paid. In response, Appling told the Firm that he was expecting a tax refund of approximately \$100,000 that was enough to cover his current and future legal fees. Based on this statement, the Firm continued to represent Appling in the litigation. Without the Firm's knowledge, Appling subsequently requested a tax refund of only \$60,718, and ultimately received only \$59,581. Appling never paid the Firm any of these funds, and instead spent the money on his business. Appling subsequently told the Firm that he had not yet received the refund, and the Firm agreed to finish the litigation and delay collection of the outstanding fees.

Appling subsequently filed a Chapter 7 petition. The Firm filed an adversary proceeding alleging that Appling's debt was

nondischargeable pursuant to section 523(a)(2)(A) of the Bankruptcy Code. Section 523(a)(2)(A) excepts from discharge a debt for money, property, services or an extension, renewal or refinancing of credit, to the extent obtained by “false pretenses, a false representation, or actual fraud ***other than a statement respecting the debtor’s ... financial condition.***” (emphasis added). Section 523(a)(2)(A) stands in contrast to section 523(a)(2)(B) which excepts from discharge debts for money, property, services or an extension, renewal or refinancing of credit to the extent obtained by “use of a statement in writing” that is materially false, that is “respecting the debtor’s ... financial condition”, on which the creditor reasonably relied and that the debtor caused to be made or published with the intent to deceive.

Appling moved to dismiss the adversary proceeding, arguing that his two statements concerning the tax refund were statements respecting his financial condition and therefore were governed by section 523(a)(2)(B), and that because the statements were not “in writing” the Firm’s nondischargeability claim should be dismissed. The Bankruptcy Court held that a statement regarding a single asset is not a “statement respecting the debtor’s financial condition” for purposes of section 523(a)(2)(B) and denied Appling’s motion to dismiss. After trial, the Bankruptcy Court found that Appling had in fact made two false statements upon which the Firm had justifiably relied and held that Appling’s debt to the Firm was nondischargeable under section 523(a)(2)(A). The District Court affirmed. However, the Eleventh Circuit Court of Appeals held that “statement[s] respecting the debtor’s ... financial condition may include a statement about a single asset” and therefore the Firm’s nondischargeability claim was governed by section 523(a)(2)(B). Because Appling’s statements were

not in writing, the Court of Appeals held that Appling's debt to the Firm was not subject to a finding of nondischargeability pursuant to section 523(a)(2)(B).

The Supreme Court affirmed the Court of Appeals' decision. The Court reached its decision by looking to the language of section 523(a)(2)(B). The key terms explored by the Court were "statement," "financial condition" and "respecting." Not surprisingly, the Court accepted the standard dictionary definition of the term "statement." The parties agreed, as did the Solicitor General, that "financial condition" meant one's overall status. The real point of definitional contention was the meaning of "respecting." In an effort to narrow the scope of section 523(a)(2)(B), and thus to apply section 523(a)(2)(A) to its claim, the Firm advanced a limited definition of "respecting," but this was rejected by the Court. The Justices found that use of the word "'respecting' in a legal context generally has a broadening effect, ensuring that the scope of a provision covers not only its subject but also matters relating to that subject."

Based on the broad scope of "respecting" the Court rejected the Firm's contention that a "statement respecting the debtor's financial condition" means only a statement that captures the debtor's overall financial status. Instead, 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." Because a single asset can bear upon the debtor's overall financial condition, a statement about a single asset can be a "statement respecting the debtor's financial condition" and thus is subject to section 523(a)(2)(B). Therefore, because Appling's statements concerning the tax return were not in writing, the Firm's claim arising from the statements did not meet the requirements of

section 523(a)(2)(B). Applying therefore “got away” with his false statements and his debt to the Firm was discharged.

What will be the impact of the Court’s decision? Clearly, it is too soon to definitively say. However, the Court’s conclusion that a statement concerning a single asset can constitute a statement concerning the debtor’s financial condition will certainly expand the scope of section 523(a)(2)(B). The primary takeaway is that creditors can protect themselves by requiring that representations regarding a potential debtor’s financial condition are in writing, therefore preserving their claims under section 523(a)(2)(B). This may prove difficult for small businesses whose practice is to extend credit or services by oral agreement. However, to the extent that false statements are not in writing, creditors are likely going to be precluded from obtaining an order of nondischargeability.

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