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Supreme Court to Tackle Fraud Exception in Lamar, Archer & Cofrin, LLP v. Appling

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January 31, 2018 - On January 12, 2018, the U.S. Supreme Court granted certiorari over the Eleventh Circuit's decision in *R. Scott Appling v. Lamar, Archer & Cofrin, LLP*, which held that a fraudulent statement regarding a single asset may constitute a statement concerning the debtor's financial condition, thereby allowing a debt incurred in reliance on the false statement to be discharged through a bankruptcy. The Eleventh Circuit's decision focused on the dichotomy established in sections 523(a)(2)(A) and (B) of the Bankruptcy Code between fraudulent statements regarding the debtor's "financial condition," which only prevent the discharge of a debt if the false statement is made in writing, and other fraudulent statements giving rise to a debt, which can prevent a discharge even if the statement is only made orally. *R. Scott Appling v. Lamar, Archer & Cofrin, LLP* will allow the Supreme Court to address a split between the Circuits on this issue, as the Eleventh Circuit's ruling is consistent with the approach adopted by the Fourth Circuit, [1] but contrary to the standard adopted by the Fifth, Eighth, and Tenth Circuit's approach, which holds that a statement about a single asset does not "respect" a debtor's financial condition as required by 523(a)(2)(A).[2]

The case arises out of an adversary proceeding initiated by Lamar, Archer & Cofrin, LLP ("Lamar") against one of its clients, R. Scott Appling. Appling incurred certain legal fees when Lamar represented him in lawsuits against the former owners of his business; however, Appling was unable to pay his legal bills when they became due. During a meeting with attorneys from Lamar, Appling conveyed that he was expecting a substantial tax refund, which he represented would be sufficient to pay his outstanding legal bill as well, as to pay any future fees incurred during the ongoing litigation. In reliance of this statement, Lamar continued its representation of Appling and did not take any steps to immediately collect its overdue fees. However, Appling's statement was false as he only received a modest refund, which he put into his business rather than to satisfy the outstanding legal fees owed to Lamar. Lamar eventually filed suit against Appling to collect the outstanding fees, and Appling subsequently filed for bankruptcy. The central issue is whether Appling's oral statements regarding his tax refund, which pertained to a single asset, respected his financial condition and is therefore dischargeable.

The Supreme Court's decision could have ramifications on the discharge of debts in bankruptcy. The narrower interpretation of the statute favored by the majority of circuits will limit the scope of the "financial condition" exception contained in section 523(a)(2)(B). This "gives effect to the fundamental bankruptcy policy that the bankruptcy courts will not provide safe haven for the perpetuators of fraud."[3] Indeed, the exception was originally conceived by Congress to address certain consumer-finance companies that were deliberately encouraging customers to submit false statements for the purpose of insulating the creditor's claim from discharge.[4] However, application of the majority view is difficult in practice because it creates "substantial line-drawing problems and may cause unjustified differential treatment of functionally equivalent scenarios."[5]

On the other hand, applying the broader interpretation put forth by the Eleventh Circuit could promote predictability and accuracy while protecting debtors from abusive credit practices.[6] It encourages creditors to rely on written statements, which are more reliable as evidence, if they later seek an exemption.[7] The office of U.S. Solicitor General advanced this position and filed a brief as Amici Curiae agreeing with the Eleventh Circuit's ruling. The Solicitor General argued that the broader interpretation best served Congress's policy goals because it "gives creditors an incentive to create writings before the fact," which may reduce fraud in the first instance.[8] By creating reliable evidence for future litigation, "such writing helps both the honest debtor prove his honesty and the innocent creditor prove a debtor's dishonesty."[9] Nevertheless, the Eleventh Circuit's interpretation could expand the exception's reach beyond its intended scope because "virtually every statement by a debtor that induces the delivery of goods or services on credit relates to his ability to pay."[10] With the "financial condition" exception taking center stage, this Supreme Court decision will certainly be one to watch.

* This post was prepared with assistance from Jiun-Wen Bob Teoh.

Footnotes

[1] See *Engler v. Van Steinburn*, 744 F.2d 1060, 1061 (4th Cir. 1984) (holding that "a debtor's assertion that he owns certain property fees and clear of other liens is a statement respecting his financial condition").

[2] See, *e.g., In re Bandi*, 683 F.3d 671, 676 (5th Cir. 2012); *In re Lauer*, 371 F.3d 406, 413-14 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700, 706 (10th Cir. 2005).

[3] Brief for Petitioner at 20, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Apr. 11, 2017).

[4] Brief for Petitioner at 22, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Apr. 11, 2017).

[5] Brief of United States as Amici Curiae at 18, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Nov. 9, 2017).

[6] Brief for Respondent at 20, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (May 25, 2017).

[7] Brief for Respondent at 20, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (May 25, 2017).

[8] Brief of United States as Amici Curiae at 8, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Nov. 9, 2017).

[9] Brief of United States as Amici Curiae at 17-18, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Nov. 9, 2017).

[10] Brief for Petitioner at 22, Lamar, Archer & Cofrin, LLP v. Appling, No. 16-1215 (Apr. 11, 2017).

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