Supreme Court to Decide Important Bankruptcy Case

Amundsen Davis Financial Services Alert
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The United States Supreme Court is poised to decide whether a mis-statement about a single asset must be in writing in order to give rise to a non-dischargeable debt for fraud.

Scott Appling supposedly orally lied to his law firm about the amount and timing of a tax refund that he would use to pay the firm's bills for representing Appling in certain business litigation. Appling did not pay these bills in full and subsequently became a debtor in a bankruptcy case under Chapter 7 of the United States Bankruptcy Code.

In a nutshell, § 523(a)(2) of the United States Bankruptcy Code requires that a false statement "respecting the debtor's . . . financial condition" be in writing in order to give rise to a non-dischargeable debt. Appling's statements were not in writing. The question, which has divided the lower courts, is whether a statement about one asset (a tax refund in this case) is a statement "respecting" financial condition.

The law firm, Lamar, Archer & Cofrin, to whom Appling supposedly lied, argued that "financial condition" refers to an overall balance sheet. Therefore, since Appling's statement dealt with only one asset, and not with his overall balance sheet, his false statement need not have been in writing to give rise to a non-dischargeable debt. Appling, on the other hand, contended that a statement about one asset is a statement "respecting" (that is, "pertaining to") financial condition. Therefore, according to him, his statements would have had to be in writing to create a non-dischargeable debt.

During oral argument, the Supreme Court seemed inclined toward Appling's view. Justice Breyer asked, if he went to get a loan and stated he had an original Vermeer painting, wouldn't that be a statement "respecting" his financial condition?

Various friend-of-the-court briefs pointed out that "financial condition" can mean cash flow or "ability to repay debt," and not necessarily mean balance sheet solvency. Historical research also showed that the phrase "respecting financial condition" first appeared in bankruptcy law in 1926 and that courts had consistently ruled that statements about single assets were statements "respecting financial condition." That understanding was known to Congress when it enacted the current Bankruptcy Code in 1978.

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We will let you know how the Supreme Court rules. But no matter how it rules, it is always prudent to get statements in writing.

Note: Amundsen Davis partner, John Collen, is also an adjunct law professor and the Director, Institute for Bankruptcy Policy at St. John's University Law School in New York. In that capacity, he served as counsel of record on a friend-of-the-court brief filed in the Supreme Court on behalf of a group of 18 law professors throughout the country. The brief supported Appling's position.