

## High Court Weighs Issue Of Fraud In Discharging Debts

By Alex Wolf

*Law360 (April 17, 2018, 10:08 PM EDT)* -- The U.S. Supreme Court tackled thorny questions Tuesday over exemptions to a debtor's ability to discharge liabilities in bankruptcy, as counsel for an Atlanta law firm duped by an insolvent client urged the justices to follow a "baseline rule" that "a debt procured by fraud is not dischargeable."

The high court is attempting to parse language in the U.S. Bankruptcy Code that determines whether or not a party can receive a completely fresh start at the end of the bankruptcy process when some of the underlying debts may have been obtained through deceit. While the code prohibits the discharge of debts that result from dishonest or fraudulent conduct, an exception that permits a discharge when the fraud consists of a false "statement respecting the debtor's ... financial condition" has resulted in differing circuit court opinions over whether a statement about a specific asset can rise to that level.

The appeal was launched by Lamar Archer & Cofrin LLP in an effort to overturn a 2017 Eleventh Circuit decision that Chapter 7 debtor R. Scott Appling could discharge a roughly \$100,000 debt to the firm for failure to pay legal fees even though Appling lied about his ability to pay Lamar Archer with funds from a tax return.

Specifically, the appeals court found that a statement about a single asset — in this case, Appling's tax return — may qualify as a statement respecting a debtor's overall financial condition and trigger the exemption to debts rooted in fraud that cannot be discharged. In doing so, the circuit court panel rejected the firm's argument that such an interpretation was inconsistent with the provision's targeted objective.

Although the decision aligned with precedent in the Fourth Circuit, Lamar Archer argued that it must be reviewed because it conflicts with holdings by the Eighth, Tenth and Fifth Circuits.

Representing the Atlanta firm at the high court, Latham & Watkins LLP attorney Gregory G. Garre argued Tuesday that Appling could not use the exemption at issue because "a statement about a single asset or a single liability is not a statement respecting financial condition." Based on the language in the bankruptcy code, Appling's representation that he would pay his legal fees using a future tax return speaks to his "ability to pay," but not his "financial condition," said Garre, a former solicitor general under former President George W. Bush.

Garre also urged the court to avoid creating a legal morass that lawmakers clearly intended to avoid.

“There's no indication at all that ... Congress had in mind such a dramatic reshifting of the ordinary regime that it has applied for a century in this context, which is a debt procured by fraud is not dischargeable,” he said. “And I think one would look skeptically to a rule that would wipe out the application of that age-old rule in a commonly recurring context, which is statements made about finances.”

The origins of the case date back to 2004, when Appling hired Lamar Archer and another firm to litigate a dispute against the former owners of a business he had recently purchased. After falling behind on legal bills, Appling assured his lawyers that he would be able to pay them in the near future after receiving a \$100,000 tax refund. But the payments never materialized, and Lamar Archer later discovered that Appling lied about the refund amount owed to him and spent the money on business expenses instead of outstanding attorneys' fees.

Appling filed for bankruptcy shortly after Lamar Archer won a judgment against him in Georgia state court in 2012.

Although Lamar Archer initially prevailed over Appling's efforts to discharge his debt to the firm when the matter went before a bankruptcy court in Georgia and then before the federal district court, the Eleventh Circuit reversed and remanded the matter after finding that Appling could extinguish the liability stemming from his fraudulent statement to the firm.

Appling's counsel urged the high court on Tuesday to uphold the Eleventh Circuit's decision, saying the statements Lamar Archer relied on to continue providing legal service for Appling spoke to his financial condition.

“[O]ur rule is that any statement that has a direct impact on one's overall financial condition, which petitioner defines as the balance of assets and liabilities, is a statement respecting financial condition,” said Mayer Brown LLP attorney Paul W. Hughes, adding that his argument is supported by the text of the statute.

An attorney for the office of U.S. Solicitor General Noel J. Francisco also urged the justices to affirm the Eleventh Circuit's findings, stressing the importance of whether or not a creditor relies on a statement to determine if it speaks to a debtor's financial condition.

“I think we're looking at what an objective observer coming at things from the creditor's side of the transaction would understand the statement to have been made for,” said attorney Jeffrey E. Sandberg.

Lamar Archer is represented by Robert C. Lamar and David W. Davenport of the firm, and by Gregory G. Garre and Jonathan Y. Ellis of Latham & Watkins LLP.

Appling is represented by Paul W. Hughes, Michael B. Kimberly and Jonathan Weinberg of Mayer Brown LLP.

The case is Lamar Archer & Cofrin LLP v. R. Scott Appling, case number 16-1215, in the U.S. Supreme Court.

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