Professor Kenneth N. Klee and Whitman L. Holt on

Supreme Court's Holding in *Lamar, Archer & Cofrin, LLP v. Appling*, 2018 U.S. LEXIS 3384 (June 4, 2018)

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Summary of Holding and Lessons to Be Learned

In a 9-0 decision authored by Justice Sotomayor, the Supreme Court of the United States holds that a debtor's statement about a single asset can be a "statement respecting the debtor's financial condition" under Bankruptcy Code section 523(a)(2), which in turn means that creditors will need to satisfy the additional requirements of section 523(a)(2)(B)—including that the statement be in writing—in order to successfully except a claim arising from such statement from the debtor's discharge. *Lamar, Archer & Cofrin, LLP v. Appling*, 2018 U.S. LEXIS 3384, at *24–25 (June 4, 2018).

The *Lamar, Archer* decision largely applies recognized principles of statutory construction to support its adoption of an "ordinary meaning" definition of the word "respecting." *Id.* at *11–19. As the opinion itself states, creditors would now be very well advised to get any representations about a debtor's assets, liabilities, or overall finances in writing. *Id.* at *24.

Legal Background

The Supreme Court long ago described "the two great objects" of the federal bankruptcy law as its operation "to grant a discharge to honest debtors who should conform to its provisions, and to distribute their property ratably among all their creditors." *Buckingham v. McLean*, 54 U.S. (13 How.) 151, 166 (1852). There has never been an absolute right to a discharge, however, and federal bankruptcy law has long included exceptions for fraudsters or other dishonest debtors. *See, e.g.*, *Liebke v. Thomas*, 116 U.S. 605, 607–08 (1886) (explaining how "[i]t is of the essence of the bankrupt law that when the bankrupt has complied with all the conditions of the statute and surrendered his property he should be released from all his debts, except those of a fiduciary character or founded in fraud").

Section 523(a) of the modern Bankruptcy Code codifies 19 categories of exceptions to discharge. Among those exceptions are a group premised on falsehoods or fraud in section 523(a)(2), which provides that an individual debtor will not be discharged from any debt—

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
> >
> > (B) use of a statement in writing—
> >
> > > (i) that is materially false;

> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive; or
>
> (C) (i) for purposes of subparagraph (A)—
>
> (I) consumer debts owed to a single creditor and aggregating more than $675 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and
>
> (II) cash advances aggregating more than $950 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and
>
> (ii) for purposes of this subparagraph—
>
> (I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and
>
> (II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor[.]

11 U.S.C. § 523(a)(2). Although suffering from some obvious grammatical problems, the essence of this statutory provision is to create two, mutually exclusive categories of exceptions. Subparagraph (A) is a form of general or catch-all category for misrepresentations and fraud other than instances involving "a statement respecting the debtor's or an insider's financial condition." This general category encompasses such matters as "fraudulent conveyance schemes, even when those schemes do not involve a false representation," *Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1590, 194 L. Ed. 2d 655 (2016), and "requires justifiable, but not reasonable, reliance" by the creditor on a debtor's misrepresentations, *Field v. Mans*, 516 U.S. 59, 74–75 (1995). Subparagraph (B) then acts as a more specific category for statements "respecting the debtor's or an insider's financial condition," which category includes several heightened requirements, including that the statement be in writing and that the creditor prove its reasonable reliance.

Facts and Proceedings Below

R. Scott Appling ("Appling") retained the law firm Lamar, Archer & Cofrin, LLP ("Lamar") to represent him in some litigation on an hourly-rate basis. *Lamar, Archer*, 2018 U.S. LEXIS 3384, at *7. Appling stopped paying his bills, and the Lamar law firm indicated that it would terminate the engagement. *Id.* At a meeting about the situation, Appling told Lamar that he anticipated getting a tax refund of "approximately $100,000," which Appling would use to pay his accrued and future legal fees. *Id.* at *7–8. In reliance on this statement, Lamar continued its representation of Appling. *Id.* at *8.

Appling lied. The tax refund was only for approximately $60,000 and Appling used it to pay other business expenses rather than paying it to the Lamar firm. *Id.* So Lamar sued Appling in Georgia state court and got a large judgment. *Id.* Appling and his wife countered by filing a chapter 7 case, claiming more than $550,000 in property as exempt. *Id.* at *8–9. Lamar filed an adversary proceeding to determine that its judgment was not subject to discharge under Bankruptcy Code section 523(a)(2)(A) because of Appling's fraud. *Id.* Appling responded by moving to dismiss on the basis that his statements about the tax refund were about his financial condition such that the exception in section 523(a)(2)(A) applied and Lamar was required to prove the elements of section 523(a)(2)(B). *See id.* at *9. Both the bankruptcy court and the district court rejected Appling's position. *See Lamar, Archer & Cofrin, LLP v. Appling (In re Appling)*, 500 B.R. 246, 252 (Bankr. M.D. Ga. 2013), *aff'd*, 2016 U.S. Dist. LEXIS 39958 (M.D. Ga. Mar. 28, 2016). The Court of Appeals for the Eleventh Circuit disagreed, however, and adopted Appling's construction of the statute, recognizing that "[t]he circuits and other federal courts are split on this question." *Appling v. Lamar, Archer & Cofrin, LLP (In re Appling)*, 848 F.3d 953, 957 & 960–61 (11th Cir. 2017).

Based on this established circuit split, the Supreme Court granted Lamar's petition for writ of certiorari on January 12, 2018. *See Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 734, 199 L. Ed. 2d 601 (2018). The parties completed briefing in the Spring of 2018, and the case was argued on April 17, 2018. The Solicitor General somewhat surprisingly participated in both briefing and argument as amicus curiae supporting Appling's construction of the statute. *See Lamar, Archer*, 2018 U.S. LEXIS 3384, at *16.

Analysis

Justice Sotomayor's opinion begins by framing the case before the Court as one "about what constitutes a 'statement respecting the debtor's financial condition.' Does a statement about a single asset qualify, or must the statement be about the debtor's overall financial status?" 2018 U.S. LEXIS 3384, at *6–7. Before analyzing that question, the Court briefly recounts the facts and procedural history of the dispute. *See id.* at *7–10.

Turning to the specific issue before it, the Court describes how "the Bankruptcy Code contains broad provisions for the discharge of debts, subject to exceptions," including those contained in section 523(a)(2). *Id.* at *10–11. The Court then moves to the statutory text. *Id.* at *11. "Because the Bankruptcy Code does not define the words 'statement,' 'financial condition,' or 'respecting,' we look to their ordinary meanings," *id.* at *11, which ordinary meanings the Court derives by reviewing several dictionaries. *See id.* at *11–14. This review of the lexicon leads the Court to conclude that the

preposition "respecting" typically has a broad connective meaning, which is consistent with how "[u]se 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." *Id.* Under this ordinary meaning of the word, "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." *Id.* at *18. And because "[a] single asset has a direct relation to and impact on aggregate financial condition, so a statement about a single asset bears on a debtor's overall financial condition and can help indicate whether a debtor is solvent or insolvent, able to repay a given debt or not," it further follows that "a statement about a single asset can be a 'statement respecting the debtor's financial condition.'" *Id.*

The Court rejects Lamar's narrower interpretation of the word "respecting" as one that would lead to "inexplicably bizarre" and "incoherent results." *See id.* at *18–19. Among other issues, a narrow interpretation could mean that "the ability to discharge a debt turns on the superficial packaging of a statement rather than its substantive content" and that highly-generalized statements would need to be in writing while highly-specific statements would not need to be in writing. *Id.* at *19.

The Court further grounds its conclusion in the textual history of section 523(a)(2) by tracing its genesis back to a 1926 amendment to the 1898 Bankruptcy Act, *id.* at *19–20, and (in a part of the opinion not joined by Justices Thomas, Alito, and Gorsuch) the legislative history to the 1978 Bankruptcy Code, *id.* at *21–24. In the process, the Court deploys the interpretative principle that "[w]hen Congress used the materially same language in § 523(a)(2), it presumptively was aware of the longstanding judicial interpretation of the phrase and intended for it to retain its established meaning." *Id.* at *20.

The opinion draws to a close by rejecting a policy argument offered by Lamar while offering some practical advice:

> [A]lthough Lamar tries to paint a picture of defenseless creditors swindled by lying debtors careful to make their financial representations orally, creditors are not powerless. They can still benefit from the protection of § 523(a)(2)(B) so long as they insist that the representations respecting the debtor's financial condition on which they rely in extending money, property, services, or credit are made in writing. Doing so will likely redound to their benefit, as such 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.

Id. at *24. Based on its specific holding "that a statement about a single asset can be a 'statement respecting the debtor's financial condition' under § 523(a)(2) of the Bankruptcy Code," the Court ultimately affirms the judgment of the Court of Appeals for the Eleventh Circuit that allowed Appling to discharge the debt he owed Lamar for unpaid legal fees. *See id.* at *24–25.

Practice Tips

The most immediate practice tip generated by the *Lamar, Archer* decision is the one explicitly stated by the Supreme Court at the conclusion of the opinion—creditors should get ***every***

representation about a debtor's assets, liabilities, or overall finances in writing. Absent such a writing, Bankruptcy Code section 523(a)(2) will not allow creditors to use oral misrepresentations by the debtor about such matters to support an exception to discharge in bankruptcy.

More broadly, *Lamar, Archer* further solidifies the force of interpretative principles that the Supreme Court often uses in its bankruptcy cases. First, the Court has again demonstrated that when the Bankruptcy Code itself does not define a word or phrase, the Court will look for its "ordinary meaning" in dictionaries. *See* Kenneth N. Klee & Whitman L. Holt, *Bankruptcy and the Supreme Court: 1801-2014,* at 20 n.102 & accompanying text (West Academic 2015). Second, the Court has further reiterated that Congress is presumed to know the law and thus to have incorporated past bankruptcy practice and judicial interpretation absent a clear indication that Congress intended otherwise. *See id.* at 17 n.88 & accompanying text.

Finally, *Lamar, Archer* teaches that although history doesn't repeat itself, it often rhymes. More than 103 years earlier, the Supreme Court also allowed an individual debtor to defraud his lawyers and escape the consequences through the bankruptcy process on the ground that the text of the bankruptcy statute simply did not encompass the debtor's misconduct. *See* *Gleason v. Thaw*, 236 U.S. 558, 561–62 (1915) (holding that a claim of an attorney who was defrauded into providing legal services by the debtor's misrepresentations about his assets was not excepted from discharge under the 1898 Bankruptcy Act since that statute encompassed only "liabilities for obtaining *property* by false pretenses or false representations," not liabilities incurred for *services* obtained by fraud).[1] Perhaps as a very general matter, then, one could conclude that the Supreme Court institutionally is disinclined to protect lawyers who might have taken steps to protect themselves from being defrauded by their own clients.

About the Author(s). Kenneth N. Klee is a nationally recognized expert on bankruptcy law. He became a Professor of Law Emeritus at the UCLA School of Law in 2014 and is a founding partner of Klee, Tuchin, Bogdanoff & Stern LLP, specializing in corporate reorganization, insolvency, and bankruptcy law. From 1974 to 1977, Professor Klee served as associate counsel to the Committee on the Judiciary, U.S. House of Representatives, where he was one of the principal drafters of the 1978 Bankruptcy Code. He served as a consultant on bankruptcy legislation to the U.S. Department of Justice in 1983–1984. From 1992 to 2000, he served as a member of the Advisory Committee on Bankruptcy Rules to the Judicial Conference of the United States. From 2000 to 2003, and previously from 1988 to 1990, Professor Klee has served since 2017 as a board member of the Ninth Judicial Circuit Historical Society and served as a member of the Advisory Board for several years before that. He has served three times as a lawyer delegate to the Ninth Circuit Judicial Conference. Professor Klee served as member of the executive committee of the National Bankruptcy Conference from 1985 to 1988, 1992 to 1999, 2005 to 2008, and 2011 to 2014 and currently serves as Chair of its Membership Committee. He served from 2011 to 2014 as Chair of the NBC's Committee to Rethink

1 The amounts at issue in *Gleason v. Thaw* are astonishing. R. Scott Appling ultimately incurred roughly $100,000 in unpaid legal fees by lying about a tax refund of approximately the same amount. Harry K. Thaw incurred roughly $60,000 in unpaid legal fees by falsely claiming "that he was the owner of an interest of at least $500,000 in the estate of his father and had an annual income of $30,000 in his own right." *See* 236 U.S. at 559. When presented in 2017 dollars, however, Thaw's unpaid fees were nearly $1.48 million and were derived from misrepresentations about more than $13 million in assets! *See generally* The Inflation Calculator, https://westegg.com/inflation/. Thaw's fraud on his lawyers was thus orders of magnitude larger than Appling's fraud on his lawyers.

Chapter 11 and also served as chair of its legislation committee from 1992 to 2000. Professor Klee is a past president and member of the board of governors of the Financial Lawyers Conference. Professor Klee was included in "The Best Lawyers in America" 2018 edition and has been included for at least 25 years. He has been named by *Who's Who Legal*, since 2012, as one of the top ten insolvency & restructuring attorneys in the world and was named by *The Legal 500* as one of the top nine leading attorneys in the municipal bankruptcy field for 2014. From 2003 to 2011 and periodically thereafter he was named by the *Daily Journal* as one of California's Top 100 Lawyers. Professor Klee is an author or co-author of four books: *Bankruptcy and the Supreme Court: 1801*–2014 (with Whitman L. Holt) (West Academic 2015); *Bankruptcy and the Supreme Court* (LexisNexis 2008); *BusinessReorganization in Bankruptcy* (West 1996; 2d ed. 2001; 3d ed. 2006; 4th ed. 2012); and *Fundamentals of Bankruptcy Law* (ALI-ABA 4th ed. 1996). He has authored or co-authored 32 law review articles on bankruptcy law. Recently, and within the past few years, Professor Klee has served as cocounsel for Bettina Whyte as COFINA agent in the Puerto Rico PROMESA restructuring cases; cocounsel for defendants Anadarko Petroleum Corp. and Kerr McGee in *Tronox v. Anadarko* (Bankr. S.D.N.Y.). and the Blavatnik defendants in *Weisfelner v. Blavatnik (In re Lyondell Chemical Co.)* (Bankr. S.D.N.Y.). During the summer of 2010, Professor Klee served as the appointed Examiner in the Tribune chapter 11 cases. He also represented Jefferson County, Alabama, in its successful Chapter 9 case from 2011 to 2014. Professor Klee also serves clients as an expert witness, mediator, arbitrator, attorney, or consultant in his Chapter 11 business reorganization practice.

Whitman L. Holt is a partner of Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles. Mr. Holt has represented clients across the bankruptcy spectrum, including borrowers in and out of court, debtors subject to involuntary bankruptcy petitions, municipal debtors, secured creditors in and out of bankruptcy, hedge and distressed debt funds, equity sponsors, plaintiffs and defendants in bankruptcy-related litigation, and purchasers of assets via chapter 11 plans and section 363 sales. Mr. Holt also has significant experience regarding various alternative insolvency regimes, including bank and thrift receiverships under title 12 of the U.S. Code and proceedings for troubled insurers under state law. Mr. Holt's active bankruptcy-related appellate practice includes briefing multiple matters before the Supreme Court of the United States, including the prevailing merits brief in the landmark *Stern v. Marshall* case. Mr. Holt is the co-author (with Kenneth N. Klee) of *Bankruptcy and the Supreme Court: 1801–2014* (West Academic 2015), which is a comprehensive desk reference for lawyers, judges, law students, and scholars examining the Supreme Court's bankruptcy decisions from 1801 through 2014 from six different perspectives. Mr. Holt has consistently been recognized as one of the top corporate bankruptcy and restructuring attorneys in California by *Super Lawyers Magazine* and by *Chambers & Partners*. In 2015, Mr. Holt was elected as a Conferee of the National Bankruptcy Conference, which is an invitation-only organization dedicated to advising Congress about the operation of bankruptcy and related laws and which is widely regarded as the most prestigious professional organization in the bankruptcy field. In 2017, Mr. Holt was included in the American Bankruptcy Institute's inaugural list of "40 Under 40" bankruptcy, insolvency, and restructuring professionals from around the world. Mr. Holt is a graduate of Bates College (B.A., 2002, *magna cum laude* and Phi Beta Kappa) and Harvard Law School (J.D., 2005, *cum laude*).

The views stated herein are those of the authors individually, not of the UCLA School of Law; Klee, Tuchin, Bogdanoff & Stern LLP; or any client.