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CREDITORS' RIGHTS AND BUSINESS RESTRUCTURING ALERT

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SUPREME COURT SAYS CREDITORS MUST "GET IT IN WRITING"

By Daniel M. Pereira and Richard A. Barkasy

On June 4, the U.S. Supreme Court sent a clear message regarding the requirements for non-dischargeability under the Bankruptcy Code, holding that a debtor's misleading statement to a creditor regarding a single asset was a statement "respecting the debtor's . . . financial condition" which must be in writing to render the resulting obligation non-dischargeable. In Lamar, Archer & Cofrin, LLP v. Appling, Appling had fallen behind on legal bills owed to Lamar. When Lamar told him it would withdraw its representation and impose a lien on its work product, Appling advised Lamar that he would be receiving a $100,000 tax refund and in reliance, Lamar continued to provide legal services. Subsequently, Appling received only a $60,000 tax refund, spent the funds on his business, and told Lamar that he had not yet received the return. After Appling failed to pay his bills, Lamar obtained a state court judgment at which point Appling filed for bankruptcy protection and Lamar instituted an adversary proceeding seeking a non-dischargeability determination.

At issue was the language of Section 523(a)(2)(b) of the Bankruptcy Code which requires misstatements "respecting the debtor's or an insider's financial condition" to be made in writing in order for the resulting obligation to be considered non-dischargeable in bankruptcy. In contrast, under Section 523(a)(2)(a), which expressly excludes statements regarding a debtor's financial condition, obligations are non-dischargeable where they arise from "false pretenses, a false representation, or actual fraud" regardless of whether there is a writing. Therefore, whether an intentional misstatement must be reduced to a writing to result in non-dischargeability turns on whether the misstatement is "respecting the debtor's . . . financial condition."

Lamar asserted that because Appling made false statements regarding his tax refund, the resulting obligation was non-dischargeable under Section 523(a)(2)(a). Appling moved to dismiss, arguing that because his misstatements were "respecting" his "financial condition," they were required to be in writing to trigger non-dischargeability. The bankruptcy court and the district court agreed with Lamar and found that a statement regarding a single asset is not a statement regarding a debtor's financial condition and therefore, under Section 523(a)(2)(a), Appling's obligations to Lamar were non-dischargeable despite the fact that his misstatements had never been reduced to writing. The 11th Circuit reversed. On appeal to the Supreme Court, Lamar argued that the phrase "respecting the debtor's . . . financial condition" should be read narrowly to include only misstatements regarding a debtor's overall financial status. However, the Supreme Court agreed with Appling that because a debtor's statement regarding a single asset implicates the sum of the debtor's assets and liabilities, such a statement falls within the purview of Section 523(a)(2)(b) and must be reduced to a writing to trigger non-dischargeability.

The lesson for creditors is simple but crucial: ALWAYS GET IT IN WRITING. When a creditor agrees to extend credit based on any representations of a borrower regarding its income, assets, net worth or aspects of its financial condition, the creditor should insist that the representations be included in a document, which to remove all doubt, should be signed by the borrower. If the representations later turn out to be false and the borrower seeks to avoid the resulting obligation through a bankruptcy, the written statement will provide the creditor with the non-dischargeability protections of Section 523(a)(2)(b).◆

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