SCOTUS Ruling Means Dishonest Debtors Can Discharge Their Debts in Bankruptcy

June 5, 2018 - Can a debtor lie to get access to credit and then use bankruptcy proceedings to have that debt thrown out? That was the question argued before the Supreme Court in November. And this week we got our answer. In a unanimous ruling the justices said that unless the lie was in writing, the answer is "yes."

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The ruling in Lamar, Archer & Cofrin, LLP v. Appling is a warning to any company that extends credit to its clients. Any agreement extending credit must be in written form if the creditor wants to protect themself from financial losses due to a bankruptcy filing.

Here is the case in a nutshell. Lamar, Archer & Cofrin is a law firm that represented R. Scott Appling in a legal matter. Over the course of time, Appling fell behind on his legal payments and the law firm threatened to end its representation. To prevent this, Appling orally informed the firm that he was expecting a tax refund of $100,000. That would have been more than enough to cover his entire outstanding legal bill. Based on that statement, the law firm said that it would continue to represent Appling. But nothing was put in writing and eventually became clear that Appling had no intention of paying his debt. So the law firm filed suit against him. Shortly after that, Appling filed for Chapter 7 bankruptcy protection.

US bankruptcy law specifically exempts certain debts from bankruptcy protection if the debts were incurred due to "false pretenses, a false representation, or actual fraud other than a statement respecting the debtorâ€™s â€¦ financial condition." But the justices found that an oral statement about a tax return could reasonably be considered "a statement respecting the debtor's financial condition," and therefore bankruptcy protections did apply. Had the firm received a written statement about the tax return, which could have been considered a "false representation," the firm likely would have been protected.

The moral of the story here is that if you run a business and you rely on oral statements from your customers to extend them credit, you could wind up holding the bag if your customers ever file for bankruptcy. All credit agreements need to be in writing.
byJim Malmberg
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