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EVERYTHING IN ITS RIGHT PLACE: THE SUPREME COURT AND THE BANKRUPTCY FRAUD EXCEPTION

William Miller

I. INTRODUCTION

Language cannot exist without ambiguity. Throughout history, ambiguous language has been both a burden and a boon on the ability to effectively communicate ideas and expressions. On one hand, ambiguity is an obstacle that can either distort or jettison any rational meaning from a sentence. On the other hand, ambiguity is essential to any language. If languages are too exact and well-defined, to the point that that every word possesses only one meaning, it would be nearly impossible to communicate complex concepts.

In the legal field, ambiguity serves a similar double-edged role. Statutes and laws without clear meaning make it difficult for citizens, especially those without any legal knowledge, to understand permissible and impermissible behavior. However, indoctrinated in criminal law is the rule of lenity, which requires the ambiguities in criminal statutes to be resolved in favor of the defendant.¹ As evidenced by the legal concept of lenity, ambiguity has a prolific history within the legal field, and ambiguity serves as a crux for the analysis of this Article.

Recently, the Supreme Court granted a petition for a writ of certiorari in the case of *In re Appling*, to interpret two sections of the Bankruptcy Code regarding the nondischargeability of debt based on false pretenses or representation, actual fraud, or false financial statements.² There is a widening split among circuit courts as to the proper interpretation of 11 U.S.C. § 532(a)(2), which stems from inconsistent interpretation of the provision. Courts have reached conflicting interpretations of a statement respecting the debtor's or insider's financial condition.³ Determining the appropriate interpretation is key to deciding whether certain statements, though fraudulently expressed, are dischargeable under the Bankruptcy

1. See *Leocal v. Ashcroft*, 543 U.S. 1, 12 n. 8 (2004) (indicating the rule of lenity should be applied as a last resort of statutory construction, so long as not contrary to legislative intent).

2. *In re Appling*, 848 F.3d 953 (11th Cir. 2017); *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752 (2018).

3. *In re Bogdanovich*, 292 F.3d 104, 112–113 (2d Cir. 2002) (quoting language from 11 U.S.C. § 532(a)(2)). See 11 U.S.C. § 523(a)(2): discharge under this title does not discharge a debt in the form of 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.

Code. In *In re Appling*, the Eleventh Circuit attributed too broad of an interpretation to §§ 523(a)(2)(A) and (B) when determining whether a statement about a single asset was a “statement respecting the debtor’s financial condition.”⁴ In analyzing *In re Appling*, the Supreme Court should apply a narrower interpretation as was done by the Fifth Circuit in the case *In re Bandi*.⁵

Part II of this Article provides background information pertaining to the development of the federal Bankruptcy Code and its purpose. Additionally, the section focuses on the bankruptcy process and the role discharge plays; discussing both the role and policy of discharges and more specifically the roles and policy of the fraud exception. Finally, Part II distinguishes §§ 523(a)(2)(A) and (B) to shed light on their meaning and applicability. Part III compares the courts’ decisions in *In re Appling* and *In re Bandi*, analyzing the courts’ rationales and interpretations. The section also compares decision theories to predict the Supreme Court’s ultimate assessment on the circuit split.

II. BACKGROUND

The Bankruptcy Act of 1800 was the first federal law Congress passed related to bankruptcy.⁶ Comparable to many state bankruptcy systems at the time, the Bankruptcy Act of 1800 was creditor-oriented and only allowed involuntary bankruptcies for merchant debtors, those who incur debt through commercial transactions.⁷ In 1898, Congress passed a bankruptcy law that became essentially permanent, though it has been amended and replaced multiple times since its introduction.⁸ Subsequent subsections of this Article will trace the current Bankruptcy Code’s development, including Congress’ recognition to modernize bankruptcy law, including a brief synopsis of the legislative history. Following the Bankruptcy Code’s development, this Article will examine different theories behind the current code, including the debtor’s “fresh start.” Discussion then focuses on the role of discharge of debts in bankruptcy, and finally concentrates on the fraud exceptions to discharge found in 11 U.S.C. § 523.

4. *Appling*, 848 F.3d at 961 (Rosenbaum, J., concurring).

5. *In re Bandi*, 683 F.3d 671 (5th Cir. 2012).

6. David Haynes, *History of Bankruptcy in the United States*, THE BALANCE (Apr. 29, 2018), <https://www.thebalance.com/history-of-bankruptcy-in-the-united-states-316225>.

7. *Id.*

8. *Id.*

A. Bankruptcy Code's Development

In 1970, Congress created the National Bankruptcy Review Commission, to recommend changes to the bankruptcy laws established by the Bankruptcy Act of 1898.⁹ The Commission was tasked with “considering the basic philosophy of bankruptcy, its causes, possible alternatives to the present system of bankruptcy administration, the applicability of advanced management techniques to administration of the Act, and such other matters as the Commission should deem relevant to its assigned mission.”¹⁰

Legislation based on the Commission's report was introduced in both the Senate and House in 1973.¹¹ After years of hearings, rather different bills, H.R. 8200 and S. 2266 were introduced, neither of which bore a close resemblance to the Commission's draft.¹² Following nearly a decade of study and deliberation, President Carter signed the Bankruptcy Reform Act of 1978 into law on November 6, 1978.¹³ The law took effect October 1, 1979, with some of the provisions, particularly those affecting bankruptcy courts, phased in over a five-year transition period.¹⁴ The Bankruptcy Reform Act of 1978 favored protection for the rights of consumer debtors by encouraging greater use of the Chapter 13 mode of relief allowing for the restructuring of debts of individuals with regular income.¹⁵ The hope was that creditors would be paid more in Chapter 13 and that debtors would emerge with better credit.¹⁶

B. Bankruptcy's Purpose

Bankruptcy law sprouted a spirited discourse concerning its theoretical origins, which remains largely unsettled.¹⁷ Perhaps this is

9. S.J. Res. 88, Pub. L. No. 91-354, 84 Stat. 468 (1970).

10. National Bankruptcy Review Commission, *The Commission: Its History and Process* (Nov. 26, 1997), (quoting REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, at 1 (1973)).

11. Charles E. Andersen, *Bankruptcy Reform Act of 1978*, HG, <https://www.hg.org/article.asp?id=19818>. See H.R. 8200, 95th Cong. (1997–1978); S. 2266, 95th Cong. (1997–1978).

12. Anderson, *supra* note 11.

13. Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 34 (1995).

14. *Id.*

15. *Id.* at 35. See generally 11 U.S.C. § 1326 (where the Chapter 13 bankruptcy payment plan is discussed. Chapter 13 bankruptcy enables debtors with regular income to retain their assets and develop a plan to repay all or part of their debts, typically over a three to five year period).

16. Tabb, *supra* note 13, at 35.

17. ELIZABETH WARREN ET AL., THE LAW OF DEBTORS AND CREDITORS 5 (7th ed. 2014).

because bankruptcy varies for consumer debtors and business debtors in its operation and outcome. In the consumer realm, many, if not most, American theorists accept that bankruptcy is largely about a “fresh start” for the individual debtor.¹⁸ Most frequently, people equate the “fresh start” with the economic rehabilitation of debtors through bankruptcy’s discharge of debt.¹⁹ This economic theory of the fresh start advocates a contractual approach to bankruptcy; the fresh start operates with an insurance-like function of bankruptcy’s discharge.²⁰ Other theorists posit morality-based grounds of the discharge, observing the deep-seated norm of forgiveness in many western cultures.²¹ Regardless of the theoretical underpinnings behind the concept, most theorists believe consumer bankruptcy is about the fresh start. The idea is that the fresh start allows former debtors to earn, spend, borrow, and repay money at a manageable pace.²²

Business bankruptcy, at least from a creditor’s perspective, addresses the problem of the “common pool,” which is the difficulty of acting collectively and cooperatively to maximize the value of a debtor’s assets (and thus the creditor’s aggregate return).²³ Put simply: creditors who take individual action to recoup their debts may back the debtor into a situation—going out of business—where he cannot work at all. Consequently, the debtor will no longer have wage income. The result being, the creditors recover less from the debtor through the bankruptcy process.²⁴ A number of scholars argue that bankruptcy law reflects an enormous complex of conflicting social and economic goals that cannot be over simplified.²⁵ Among these conflicting goals is the idea that creditor’s interests are prioritized above those of owners of the business or its employees.²⁶

One point is conceded by all: a major goal of bankruptcy is to

18. *Id.* at 6 (quoting language used by the Court in *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934)).

19. National Bankruptcy Review Commission, *supra* note 10, at 73–74.

20. *See, e.g.*, Barry E. Adler, *Bankruptcy Primitives*, 12 AM. BANKR. INST. L. REV. 219, 219 (2004).

21. Warren et al., *supra* note 17; *see, e.g.* Heidi M. Hurd & Ralph Brubaker, *Debts and the Demands of Conscience: The Virtue of Bankruptcy* (Oxford Univ. Press forthcoming).

22. Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy’s Fresh Start*, 92 CORNELL L. REV. 67, 68 (2006).

23. Warren, *supra* note 17 at 7.

24. *See generally* Eric Posner & E. Glen Weyl, *A Solution to the Collective Action Problem in Corporate Reorganization*, Coase-Sandor Institute for Law & Economics Working Paper No. 653, 2013 (describing the collective action problem in corporate Chapter 13 bankruptcy filings).

25. Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1993).

26. Warren et al., *supra* note 17.

preserve value.²⁷ Bankruptcy preserves economic value through liquidation and reorganization.²⁸ The collective approach to orderly asset liquidation is typically more value-preserving than the seizure and sale by a group of competing creditors.²⁹ Reorganization bankruptcy preserves the “going concern” value of ongoing business, reflecting the economic fact that businesses, like people, are often worth more alive than dead.³⁰

C. Bankruptcy and the Role of Discharges

As noted earlier, the bankruptcy process, while the same in some respects, differs for a consumer debtor filing and for a business debtor filing, and differs depending upon the chapter under which the debtor chooses to file.³¹ The focus of this Article is not on the bankruptcy process itself, however, having a basic understanding is important to comprehending this Article’s focus. Consequently, this Article provides a general description of bankruptcy and its processes.

There is a bankruptcy court for each judicial district in the country, with a total of ninety bankruptcy districts across the country.³² The procedural aspects of the process are governed by the Federal Rules of Bankruptcy Procedure (“Bankruptcy Rules”) as well as local rules of each bankruptcy court.³³

The bankruptcy process balances two principal concerns.³⁴ First, it seeks to relieve an overburdened debtor from “oppressive” debt through discharge.³⁵ Secondly, it organizes the debtor’s assets so that they may be fairly apportioned among creditors with claims against the debtor.³⁶ A bankruptcy case begins when the debtor files a petition with the bankruptcy court in the jurisdiction in which he or she resides.³⁷ The debtor must provide financial information, including a list of assets, debts, and creditors.³⁸ Once the debtor files the bankruptcy petition, an

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. United States Courts, *Process – Bankruptcy Basics*, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics>.

32. *Id.*

33. Warren et al., *supra* note 17.

34. *Id.*

35. *Id.*

36. Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE LJ. 857, 857 (1982).

37. Rebecca L. Saitta, *Overview of the Bankruptcy Process*, 59 VIRGINIA LAWYER 38, 38 (June 2010), http://www.vsb.org/docs/valawyeremagazine/v10710_bk-overview.pdf.

38. *Id.*

automatic stay takes effect, which bars debt collection efforts against the debtor, unless otherwise permitted by the bankruptcy court.³⁹ The debtor's creditors are notified of the filing and the court appoints a trustee to oversee the administration of the debtor's bankruptcy estate.⁴⁰

The bankruptcy estate is a deliberately expansive concept that includes all property owned by the debtor, with few exceptions set forth in the Bankruptcy Code (the "Code").⁴¹ In Chapter 7 cases, the debtor will usually obtain an order discharging most of his or her debts within three to four months.⁴² Chapter 13 cases typically require expenditures to creditors over numerous years before a debtor will obtain an order discharging his or her debts.⁴³

As discussed previously, the Bankruptcy Commission's findings in 1973 summarized the prevailing view: "bankruptcy should rehabilitate debtors for continued and more value-productive participation in economic life."⁴⁴ The Code implements the debtor rehabilitation policy through its discharge provisions.⁴⁵ The Bankruptcy Code authorizes a broad discharge, which provides a fresh start to "honest but unfortunate debtors."⁴⁶ The bankruptcy discharge releases the debtor from personal liability of the debts specified within applicable provisions. In other words, the debtor no longer has an obligation to pay debts that are judicially determined to be discharged.⁴⁷ The discharge is a permanent directive barring creditors from engaging in any collection efforts against the discharged debts, including legal action and communication with the debtor.⁴⁸ In Chapter 7 cases, the debtor does not have an

39. 11 U.S.C. § 362 (§ 362 codifies the automatic stay; notable exceptions of the automatic stay include: 11 U.S.C. § 362(b)(2)(B) of the collection of domestic support obligations from property that is not property of the estate; § 362(b)(2)(F) of the interception of a tax refund, as specified in applicable sections of the Social Security Act; § 362(b)(2)(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act).

40. Saitta, *supra* note 37.

41. Warren et al., *supra* note 17 (referencing 11 U.S.C. § 541, which includes a set of policy-based exceptions for employee contributions to retirement accounts and services performed by an individual debtor after commencement of the case—based on the fresh start concept).

42. Saitta, *supra* note 37.

43. *Id.* (Again, this is not a comprehensive insight into the bankruptcy process, it is simply an overview of the discharge of a debtor's debt as an integral and compelling part of the bankruptcy process).

44. National Bankruptcy Review Commission, *supra* note 10.

45. *See* 11 U.S.C. § 727 (Chapter 7 discharges). *See* 11 U.S.C. § 1228 (Chapter 12 discharges); 11 U.S.C. § 1328 (Chapter 13 discharges).

46. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

47. United States Courts, *Discharge in Bankruptcy – Bankruptcy Basics*, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics>.

48. *Id.*

absolute right to a discharge.⁴⁹ A creditor, the trustee, or the U.S. trustee may file an objection to the debtor's discharge.⁵⁰ A creditor must file a complaint in the bankruptcy court to object to the debtor's discharge.⁵¹ Filing a complaint objecting a debtor's discharge is referred to in bankruptcy as an "adversary proceeding."⁵²

D. The Fraud Exception § 523(a)(2)(A) and § 523(a)(2)(B)

The debts discharged vary under each chapter of the Code.⁵³ Section 523(a) of the Code specifically excepts different classifications of debts from the discharge allowed to individual debtors.⁵⁴ Meaning, the debtor is not allowed the liberation of certain debts, but instead must repay them to his or her creditors. Congress determined that certain types of debt are not dischargeable for public policy reasons, either because of the nature of the debt or because the debt was incurred due to improper behavior.⁵⁵ Generally, the exceptions to discharge automatically apply if the language of § 523(a), the focus of the remainder of this Article, applies.⁵⁶ However, the debts described in §§ 523(a)(2), (4), and (6)—debts affected by fraud or maliciousness—are not automatically excepted from discharge.⁵⁷ Instead, creditors must initiate an adversary proceeding to have the court determine whether the relevant debt may be excepted from discharge.⁵⁸

Due to the nature and philosophy of Bankruptcy law, the exceptions to dischargeability should be construed strictly, with the creditor bearing the burden to prove the exception.⁵⁹ This theory of strict interpretation is

49. *See generally* 11 U.S.C. § 727 (whereby a debtor can lose his ability to discharge debts for a variety of reasons. For example, § 727(a)(3) when the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case).

50. *Discharge in Bankruptcy, supra* note 47.

51. *Id.*

52. *Appling*, 848 F.3d at 955.

53. *See generally* 11 U.S.C. § 727; 11 U.S.C. § 1228; 11 U.S.C. § 1328.

54. *Discharge in Bankruptcy, supra* note 47.

55. *See* 11 U.S.C. § 523(a)(9) ("A discharge . . . of this title does not discharge an individual debtor from any debt for death or personal injury caused by the debtor's operation of a motor vehicle, vessel, or aircraft if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance." Clearly, the legislative intent behind this exception was to disallow debtors from discharging debts incurred through felonious operation of vehicles that cause the death or injury of others.).

56. *Discharge in Bankruptcy, supra* note 47.

57. *Id.*

58. Fed. R. Bankr. P. 7003.

59. *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986) (citing *Gleason v. Thaw*, 236 U.S. 558 (1915); *In re Danns*, 558 F.2d 114 (2d Cir. 1977)).

rational, considering the courts progression towards allowing a fresh start to “honest but unfortunate debtors.”⁶⁰ However, courts have not always applied a strict interpretation; the court in this Article’s primary case, *In re Appling*, interpreted § 523 broadly.⁶¹

The fraud exception does not allow the discharge of a debt obtained by “false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.”⁶² Which is to say, a debt obtained fraudulently is not dischargeable, unless the fraudulent statement “respects” the debtor’s (or insider’s⁶³) financial condition.⁶⁴ Also excepted from discharge is a debt obtained by use of a written statement that is “materially false; respecting the debtor’s or an insider’s financial condition; on which the creditor to whom the debtor is liable for [debt] reasonably relied; and that the debtor caused to be made or published with the intent to deceive.”⁶⁵

The Code treats debts incurred by a statement “respecting the debtor’s . . . financial condition” differently from other debts.⁶⁶ All fraud “other than a statement respecting a debtor’s . . . financial condition” is covered by subsection (A),⁶⁷ meaning that a debtor cannot discharge a debt obtained by any type of fraudulent statement, oral or written.⁶⁸ But, if a statement is made in writing “respecting the debtor’s . . . financial condition,” then subsection (B) governs.⁶⁹ To prevent discharge of a debt induced by a statement respecting the debtor’s financial condition, a creditor must show: (1) reasonable reliance; (2) the statement was intentional, materially false; and (3) the statement is in writing.⁷⁰ Accordingly, a debt obtained by a fraudulent oral statement respecting the debtor’s financial condition can be discharged in bankruptcy.⁷¹

One purpose of the fraud exception to discharge is to rebuke the debtor for engaging in fraudulent conduct, under the belief that the debtor’s dishonesty necessitates punishment.⁷² The reasons for punishing the dishonest debtor differ, but some theorists suggest

60. *See Appling*, 848 F.3d at 963. *See In re Bandi*, 683 F.3d 671 (5th Cir. 2012).

61. *Appling*, 848 F.3d at 961.

62. 11 U.S.C. § 523(a)(2)(A).

63. *See* 11 U.S.C. § 101(31)(i) (defining the term “insider” to include a relative or general partner of the debtor).

64. *Id.*

65. 11 U.S.C. § 523(a)(2)(B).

66. § 523(a)(2)(A), *supra* note 62.

67. *Id.*

68. *Appling*, 848 F.3d at 956.

69. 11 U.S.C. § 523(a)(2)(B).

70. *Appling*, 848 F.3d at 957.

71. *Id.*

72. *Birmingham Trust Nat’l Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985).

excepting fraudulently incurred debts from discharge serves to discourage debtor fraud.⁷³ Others argue that regardless of whether the fraud exception actually deters debtor fraud; dishonest debtors do not deserve the benefit of the discharge.⁷⁴ Under this theory, the fraud exception is retributive and operates as a civil penalty for moral wrongdoing.⁷⁵ A second purpose of the fraud exception focuses on the innocent reliance of the creditor instead of the debtor's waywardness.⁷⁶ In other words, the fraud exception is based on the premise that the creditor who extends credit based on misinformation or fraudulent information provided by the debtor should be protected.⁷⁷

To summarize, the rationale for the fraud exception is supported by two concerns: (1) punishing the wrongdoing debtor for his behavior; and (2) protecting the interests of innocent creditors wronged by the debtor's fraud.

III. THE ELEVENTH CIRCUIT DECISION: IN RE APPLING

In 2017, the Eleventh Circuit considered an important issue regarding the dischargeability of a debt acquired through fraudulent means.⁷⁸ Specifically, the question was whether a statement about a debtor's single asset qualifies as a "statement respecting the debtor's . . . financial condition."⁷⁹ The court, acknowledged the circuit split on the issue, and rejected to follow the Fifth, Eighth, and Tenth Circuits' holdings.⁸⁰ The court agreed with the Fourth Circuit in holding that a statement concerning a single asset may qualify as a statement concerning the debtor's financial condition.⁸¹

A. *The Majority Opinion*

In *In re Appling*, the debtor hired the law firm Lamar, Archer, & Cofrin (Lamar) to represent him in litigation against the former owners of his business.⁸² By March 2005, Appling owed the creditor, Lamar,

73. Symposium, *The Economics of Bankruptcy Reform: Discussion*, 41 LAW & CONTEMP. PROBS. 123, 169 (1977).

74. Barry Zaretsky, *Intent to Repay*, 23 WAYNE L. REV. 1073, 1091 (1977).

75. *Id.*

76. H.R. 8200, 95th Cong. (1997–1978). ??

77. *Id.*

78. *Appling*, 848 F.3d at 955.

79. § 523(a)(2)(A), *supra* note 62.

80. *See generally* *In re Bandi*, 683 F.3d at 676. *See also* *In re Lauer*, 371 F.3d 406, 413–14 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700, 706 (10th Cir. 2005).

81. *See* *Engler v. Steinburg*, 744 F.2d 1060, 1061 (4th Cir. 1984).

82. *Appling*, 848 F.3d at 955.

\$60,819 in legal fees and became unable to keep current on the bill.⁸³ During a meeting between Appling and Lamar, Appling stated he was expecting a tax refund of “approximately \$100,000,” which would be enough to pay current and future legal fees.⁸⁴ Lamar asserts it continued to provide legal service in reliance on this statement, and delayed collection of Appling’s overdue legal fees.⁸⁵ Appling received a refund of only \$59,851 and spent the money on his business.⁸⁶ In November 2005, Appling and Lamar met again, and Appling stated he had not yet received the refund.⁸⁷ Five years later, Lamar filed suit against Appling and obtained judgment for \$104,179; three months later, Appling filed for bankruptcy.⁸⁸ In response, Lamar initiated an adversary proceeding against Appling, and the bankruptcy court ruled the debt nondischargeable because Lamar justifiably relied on Appling’s fraudulent statements.⁸⁹ The district court affirmed, rejecting Appling’s argument that his oral statements “respected his financial condition and should have been dischargeable.”⁹⁰

The Eleventh Circuit reviewed the bankruptcy court’s factual findings for clear error, and its legal conclusions *de novo*.⁹¹ In determining whether Appling’s statements about a single asset are “statements respecting [his] . . . financial condition,” the court stated the starting point of analysis begins with the language of the statute itself.⁹² The Code does not define the germane terms, “respecting” and “financial condition.” Therefore, the court looked to the terms’ contexts to determine that they bear a technical sense.⁹³

The court concluded that “financial condition” likely meant one’s overall financial status.⁹⁴ Elsewhere in the Code, “insolvent” is defined as the “financial condition such that the sum of such entity’s debts is greater than all of such entity’s property.”⁹⁵ In this context, the statute uses “financial condition” to describe the whole state of being insolvent,

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Appling*, 848 F.3d at 955.

88. *Id.* at 956.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Appling*, 848 F.3d at 957 (citing *Ransom v. FIA Card Services, N.A.*, 562 U.S. 61, 69 (2011) (citation omitted)).

93. *Appling*, 848 F.3d at 957-58 (citing Antonin Scalia & Bryan A Garner, *Reading Law: The Interpretation of Legal Texts*, 69 (2012)).

94. *Appling*, 848 F.3d at 958.

95. 11 U.S.C. § 101(32)(A).

but never describes any specific asset on its own.⁹⁶ Relying on the premise that “a word or phrase is presumed to have the same meaning throughout the text,” the court determined “financial condition” references the sum of all assets and liabilities.⁹⁷ However, the court found that the phrase about a statement regarding the debtor’s financial condition does not cover only statements that encompass the entirety of a debtor’s financial condition at once.⁹⁸ The phrase “respecting the debtor’s . . . financial condition,” when read in context includes a statement about a single asset.⁹⁹

“Respecting” is defined broadly as “[w]ith regard or relation to; regarding; concerning.”¹⁰⁰ The court provides the example that documents can “relate to” or “concern” someone’s health without describing his overall medical history.¹⁰¹ The court also cited the Supreme Court’s interpretation of the phrase “with respect to” in a statute to mean “direct relation to, or impact on.”¹⁰² Furthermore, the court interpreted “respecting” in the First Amendment to include any partial step toward the establishment of religion.¹⁰³ Ultimately, a statement about a single asset “relates to” or “impacts” a debtor’s overall financial condition, and knowledge of one asset or liability is a partial step toward knowing whether the debtor is solvent or insolvent.¹⁰⁴

Lamar rejected the focus on the word “respecting” as “nothing more than a game of semantics,” and that the term is merely a grammatical device needed to connect two related terms.¹⁰⁵ The court, however, rejected this argument, contending that judges have a responsibility to interpret the whole text, and “[s]ometimes the canon [of ordinary meaning] governs the interpretation of so simple a word as a preposition.”¹⁰⁶ A statement about a single asset is still a statement respecting a debtor’s financial condition.¹⁰⁷

Lamar argued that the legislative history often used “financial statement” instead of “statement respecting debtor’s . . . financial condition,” and should thus be read to apply only to financial

96. *Appling*, 848 F.3d at 958.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.* (quoting “Respecting,” Webster’s New International Dictionary 2123 (2d ed. 1961)).

101. *Appling*, 848 F.3d at 958.

102. *Id.* (citing *Presley v. Etowah Cty. Comm’n*, 502 U.S. 491, 506 (1992)).

103. *Id.* (citing *Lemon v. Kurtzman*, 403 U.S. 602, 612 (1971)).

104. *Id.*

105. *Id.*

106. *Appling*, 848 F.3d at 958 (citing *Scalia & Garner, supra* 93, at 71).

107. *Id.*

statements.¹⁰⁸ The court disagreed with this argument as well, making clear that if Congress' intent was to say "financial statement," they would have written exactly that.¹⁰⁹ The surplusage canon supports the court's determination that "statement" should be given its ordinary meaning, instead of the technical meaning discussed by Lamar.¹¹⁰ Under this rule of interpretation, there is a presumption that the legislature put every word into the statute for a reason, and it should consequently not be interpreted in a way that renders a word superfluous.¹¹¹ In subsection (B), the statute says "use of a statement in writing."¹¹² Because a financial statement is most often a written document, interpreting the statute to only cover financial statements would render the writing requirement surplusage.¹¹³

Despite spending the majority of the opinion discussing the proper interpretation of § 523(a)(2)(A), the court stated, "[b]ecause the text is not ambiguous, we hold that 'statement[s] respecting the debtor's . . . financial condition' may include a statement about a single asset."¹¹⁴ As a policy matter, the requirement that certain statements be issued in writing encourages accuracy and predictability in bankruptcy disputes that often arise years after the facts develop.¹¹⁵ Lamar argued the court's interpretation is a "giant fraud loophole," but both the Uniform Commercial Code and Statute of Frauds support the conclusion that the law often requires that proof be in writing as a prerequisite for a claim of relief.¹¹⁶ Though the result seems harsh towards creditors, it provides them an incentive to put agreements into writing so that courts will have reliable evidence upon which to make a decision.¹¹⁷ In regards to a fraudulently incurred debt, a lender concerned about protecting his rights in bankruptcy can easily require a written statement from the debtor before extending credit.¹¹⁸ This decision strikes a reasonable balance between the "conflicting interests" of discouraging fraud and

108. *Id.* at 959.

109. *Id.*

110. *Id.* See Scalia & Garner, *supra* 93 (If possible, every word and every provision is to be given effect. None should be ignored. None should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence).

111. William N. Eskridge et al., LEGISLATION AND STATUTORY INTERPRETATION 687 (5th ed. 2007).

112. § 523(a)(2)(B), *supra* note 69.

113. *Appling*, 848 F.3d at 959.

114. *Id.* at 960.

115. *Id.*

116. *Id.*

117. *Id.*

118. *Appling*, 848 F.3d at 960.

allowing the honest but unfortunate debtor a fresh start.¹¹⁹ The code does not unfairly reward dishonest debtors, but instead insists on different requirements of proof for different kinds of statements.¹²⁰ Because a statement regarding a single asset can be a “statement respecting the debtor’s . . . financial condition,” and because *Appling*’s statements were not in writing, his debt can be discharged under § 523(a)(2)(B).¹²¹

B. Concurring Opinion

In his concurring opinion, Judge Rosenbaum disagreed with the majority’s broad reading of the phrase “statement respecting . . . the debtor’s financial condition,” which rewards a lying debtor who dishonestly obtains services.¹²² This result conflicts with the primary purpose of the Bankruptcy Act, which is to provide relief only to the honest debtor. However, Judge Rosenbaum believes the broad reading better supports congressional intent to give a fresh start to only the honest debtor than does a narrow construction of the phrase.¹²³ The reason being that the same phrase appears in both § 523(a)(2)(A) and (B), and it must have the same meaning in both subsections.¹²⁴ Though a narrow interpretation of the phrase in subsection (A) seems to further congressional intent to protect only the honest debtor, a broad construction of the phrase in subsection (B) better agrees with the congressional intent.¹²⁵ Because the words of the phrase in § 523(a)(2)(B) are ambiguous, Judge Rosenbaum believes they must be construed with an eye towards congressional intent in enacting the Code.

While the majority believes the phrase “statement respecting . . . debtor’s financial condition” is ambiguous, Judge Rosenbaum emphatically disagrees.¹²⁶ Other courts have concluded that the phrase refers only to statements about the debtor’s overall financial circumstances—which do not include statements about only a single liability or asset.¹²⁷ Among the courts that appear to have understood the phrase to have a meaning contrary to the *Appling* majority is the

120. *Id.* at 961. (Rosenbaum, J., concurring).

121. *Id.*

122. *Id.* at 961.

123. *Appling*, 848 F.3d at 961.

124. *See generally* 11 U.S.C. § 523(a)(2)(A) and § 523(a)(2)(B).

125. *Appling*, 848 F.3d at 961.

126. *Id.*

127. *Id.*

Supreme Court, though they did not expressly address the meaning of the language.¹²⁸ The Court held that a creditor must show only justifiable reliance on a fraudulent misrepresentation to be able to except the debt under § 523(a)(2)(A).¹²⁹ In arriving at this conclusion, the Supreme Court discussed §§ 523(a)(2)(A) and (B)'s references to "a statement respecting a debtor's . . . financial condition" and conveyed that the words "financial condition" in § 523(a)(2) prohibit exception of discharge "debts traceable to . . . a materially false financial statement" as a term of art referring to a statement of net worth, not a statement about a single asset or liability.¹³⁰ Three other circuit courts have also concluded the phrase must be narrowly construed to refer only to those statements about a debtor's overall net worth, though the courts do not appear to have determined the language of the phrase to have an unambiguous meaning.¹³¹

IV. THE FIFTH CIRCUIT'S DECISION: *IN RE BANDI*

Contrary to the Eleventh Circuit's conclusion in *In re Appling*, the Fifth Circuit held that a representation regarding a single asset, in this case, a particular residence or particular commercial property, is not a representation regarding "financial condition," for purposes of exception to nondischargeability.¹³²

In *in re Bandi*, Becnel was the holder of a \$150,000 promissory note executed by Bandi on behalf of RSB Companies, LLC (RSB) and personally guaranteed by Bandi and his brother.¹³³ Becnel began an adversary proceeding against each debtor alleging the debts owed to him were non-dischargeable pursuant to §§ 523(a)(2)(A) and (B).¹³⁴ Becnel's allegations included claims that: (1) the Bandi brothers falsely represented that they owned a commercial building; (2) Bandi falsely represented that he owned a condominium and another residence in New Orleans; (3) the Bandi brothers presented him with a fraudulent list of RSB's accounts receivable; (4) the Bandis never intended to repay the loan; and (5) Becnel would have never issued the loan if he was aware of the falsified information and misrepresentations.¹³⁵

128. *Field v. Mans*, 516 U.S. 59 (1995).

129. *Id.* at 77.

130. *See generally* *Field v. Mans*, 516 U.S. 59 (1995).

131. *See, e.g.*, *In re Bandi* 683 F.3d 671 (5th Cir. 2012); *In re Lauer*, 371 F.3d 406 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700 (10th Cir. 2005).

132. *In re Bandi*, 683 F.3d 671 (5th Cir. 2012).

133. *Id.* at 673.

134. *Id.*

135. *Id.*

The Fifth Circuit's analysis began with the words chosen by Congress. The word "statement" modified by the phrase "respecting a debtor's . . . financial condition," appears in both sections of § 523(a)(2). The Supreme Court has described these two subsections as "two close statutory companions barring discharge," the first of which relates to fraud "not going to financial condition" and the second of which concerns a "materially false and intentionally deceptive written statement of financial condition upon which the creditor reasonably relied."¹³⁶ The Supreme Court seemed to equate a "statement" about "financial condition" with what is commonly understood as something akin to a balance sheet or bank balance.¹³⁷ They relied upon the legislative history of § 523(a)(2)(B) regarding "the peculiar potential of financial statements to be misused not just by debtors, but by creditors who know their bankruptcy law"¹³⁸

Ruling in favor of the debtor, the Fifth Circuit concluded that the phrase "a statement respecting the debtor's or an insider's financial condition" as used in § 532(a)(2) was meant to embody the terms commonly understood in commercial use instead of a broadly descriptive phrase meant to capture any and all misrepresentations that relate to a debtor's assets or liabilities.¹³⁹ A representation that one owns a particular residence or particular commercial property says nothing about the total financial condition of the person making the statement or the ability to repay the debt.¹⁴⁰ The property about which a representation is made could be entirely encumbered, or outstanding unidentified liabilities of the debtor making the statement could be more than the value of the property.¹⁴¹

The court finds support for construing "financial condition" in § 523(a)(2) to mean the overall net worth of an individual or entity in other provisions of the Code.¹⁴² The term "financial condition" is part of the definition of the term "insolvent."¹⁴³ The words "financial condition" are used three times to define "insolvent" with respect to

136. *Field*, 516 U.S. at 66.

137. *Id.*

138. *Id.* at 76–77 (House Report on the Act suggests that Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge).

139. *In re Bandi*, 683 F.3d at 676.

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.* See 11 U.S.C. § 101(32).

three classes of entities.¹⁴⁴

At least two other circuit courts relied on a similar construction of the term “financial condition.” The Tenth Circuit similarly looked at the definition of “insolvent” in § 102(32) and that definition’s use of “financial condition” in construing §§ 532(a)(2)(A) and (B).¹⁴⁵ The court held that none of the debtor’s statements pertained to her “overall financial health” and that they were not statements “respecting” her “financial condition” within the meaning of §§ 523(a)(2)(A).¹⁴⁶ The Tenth Circuit reasoned that statements within the meaning of that section “are those that purport to present a picture of the debtor’s overall financial health.”¹⁴⁷ The Eighth Circuit has also construed § 523(a)(2)(A) in a way consistent with the Fifth and Tenth Circuit’s construction of the provision.¹⁴⁸ The court rejected the debtor’s argument that the failure to disclose was a statement respecting the debtor’s or an insider’s financial condition, and held that the debt was not discharged.¹⁴⁹

The bankruptcy court found that the misrepresentations made by the Bandi’s regarding ownership of a commercial building, condominium development, and a residence were intended to convey the impression that the two brothers owned valuable real property and that their personal guarantees to RSB would be backed by some measure of wealth.¹⁵⁰ The Fifth Circuit concluded that these statements fell far short of representing the Bandi’s respective net worth or representing their respective “bank balances.”¹⁵¹

144. *Bandi*, 683 F.3d at 676; see 11 U.S.C. § 101(32).

145. *In re Joelson*, 427 F.3d 700, 706–07 (10th Cir. 2005) (In the case before the Tenth Circuit, the debtor made false oral representations that she owned residences in two cities, a motel, and antique vehicles in order to obtain a loan from an acquaintance).

146. *Id.* at 715.

147. *Id.* at 714 (Further explaining the Tenth Circuit’s reasoning: “We hold that such false statements are those that purport to present a picture of the debtor’s overall financial health. Statements that present a picture of a debtor’s overall financial health include those analogous to balance sheets, income statements, statements of changes in overall financial position, or income and debt statements that present the debtor or insider’s net worth, overall financial health, or equation of assets and liabilities. However, such statements need not carry the formality of a balance sheet, income statement, statement of changes in financial position, or income and debt statement. What is important is not the formality of the statement, but the information contained within it—information as to the debtor’s or insider’s overall net worth or overall income flow.”).

148. *In re Lauer*, 371 F.3d 406, 413 (8th Cir. 2004) (debtor had represented that future payments for the balance of the purchase price for limited partnership interests would be funded from a joint venture interest in a particular nursing home. The debtor did not disclose that at the time these representations were made, the nursing home has been sold).

149. *Id.*

150. *In re Bandi*, 683 F.3d at 678.

151. *Id.* (quoting *Field*, 516 U.S. at 76).

V. STRICT CONSTRUCTION

The conclusion that an interpretive method lies at the heart of disputes among the Justices in Code cases is inescapable.¹⁵² Although bankruptcy experts might prefer that the Court take a substantive, policy-oriented view of the Code, the Court likely would prefer simply to view the Code as a statute subject to accepted interpretive rules.¹⁵³ The Justices will likely decide *In re Appling*, principally focused on statutory construction with bankruptcy policy being a secondary concern.

As Gebbia-Pinetti's empirical research suggests, the Court has a tendency to apply a textual interpretation when faced with circuit splits concerning ambiguous language.¹⁵⁴ None of the Justices are bankruptcy experts and the reality is that they are forced to review bankruptcy cases because there is no other forum for resolving circuit splits. One potential problem with applying a predominately textual interpretation is the lack of harmony in future bankruptcy cases, especially in circuit courts. With this knowledge, future circuit courts faced with appeals based on ambiguous language of the Code might have a tendency to apply a similar interpretive method, and consequently, the policy of the Code will play a secondary role.

The structure of § 523 supports the strict interpretation of "financial condition." According to the statute, statements respecting the debtor's financial condition are treated differently under the fraud provision than under the § 523(a)(2)(B) false written statement provision. Under the strict approach, in which a statement about specific assets does not constitute a statement about financial condition, a debt attained by such a statement is possibly nondischargeable. If the statement was not concerning a financial condition, then the false written statement provision would not apply. It would be reasonable for the statute to allow a debtor who orally misrepresented his overall financial condition to discharge a debt because the debtor might accidentally exclude relevant information when listing assets out loud. When focusing on a specific piece of property, it is unlikely a debtor would forget or misspeak. Similarly, it is unlikely a debtor who itemizes his or her entire financial condition in writing would make a similar error. If the term were interpreted broadly, a debtor who made an oral misrepresentation

152. Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's Bankruptcy Decisions*, 3 CHAP. L. REV. 173, 101 (2000), <https://digitalcommons.chapman.edu/chapman-law-review/vol3/iss1/7/>.

153. *Id.* at 103.

154. *See generally* Gebbia-Pinetti, *supra* note 152, at 97, 119.

about his interest in any item of property would be able to discharge the debt through bankruptcy. However, a debtor who misrepresented property ownership in writing would not be able to discharge the debt under the false written statement provision, assuming the other conditions of the provision are satisfied. Unlike the strict interpretation, this reading of the statute is not as logical or consistent with the purpose of the statute.

Public policy supports the strict interpretation of “financial condition” in the fraud exception. This construction protects creditors by barring debtors from discharging debts acquired through fraud or misrepresentation. When construed broadly, “[v]irtually any statement concerning an asset or liability arguably relates to financial condition.”¹⁵⁵ Consequently, the fraud exception to discharge could easily be avoided and debtors can escape the anti-discharge provision entirely. This sort of behavior would be in disagreement with the longstanding policy of not permitting debtors who engage in fraud to discharge their debts through bankruptcy.

Adopting the broad interpretation, as the Eleventh Circuit did, has negative public policy consequences. Simply put, someone who acquires money or property through fraud or deception should not be able to escape liability for his or her wrongdoing. Additionally, dishonest debtors should not be rewarded for their fraudulent misrepresentations, which would occur if they were allowed to discharge fraudulently obtained debts. The broad interpretation would permit many dishonest debtors to avoid the consequences of oral fraud. The better rule decides cases on their merits, rather than on the construction of an ambiguous statutory phrase that grants a fresh start without regard to the honesty of the debtor. Potential creditors may hesitate to issue loans, knowing that even if potential debtors deceive them, it will be difficult to object to discharge. Therefore, if the broad interpretation were widely accepted, it would have a chilling effect on lending. Creditors would make less loans, and even honest debtors would not be able to obtain financing as readily.

VI. CONCLUSION

The Supreme Court does not apply a single interpretive method in its Bankruptcy Code cases. Although data reveals individual Justice’s interpretive tendencies, such data also reflects that none of the

155. *In re Alicea*, 230 B.R. 492, 502 (Bankr. S.D.N.Y. 1999).

Justices have joined exclusively textual or non-textual opinions.¹⁵⁶ Textualists occasionally find enough ambiguity to consult sources other than the text, and even the non-textualists occasionally find the text to be so plain that no reference to other sources is appropriate. Some Justices lean toward textualism while others lean away from it. The Justices' diverse interpretive preferences cause many of the Court's split decisions in bankruptcy cases and contribute to the sense that the Court has no coherent interpretive strategy.¹⁵⁷

The § 523 fraud exception is a critical provision of the Bankruptcy Code, especially in the context of Chapter 7 filings and the idea of the fresh start for the honest debtor. In cases in which a debtor fraudulently obtains financing from a creditor, it is reasonable that the debtor should bear the brunt of the harm created. The text of the Code, however, should not be construed in such a manner as to conjure meaning it does not explicitly allow. For the reasons summarized in this Article, the Supreme Court should apply a strict construction of § 523(a)(2)(A) and (B) and avoid unnecessarily broadening the language of the Bankruptcy Code.

156. Gebbia-Pinetti, *supra* note 152, at 119.

157. *Id.*