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VERDICTS & SETTLEMENTS

Debt for unpaid legal fees not exempt from discharge

No showing of misrepresentation, justifiable reliance

By ERIC T. BERKMAN

A U.S. Bankruptcy Court judge has found that a judgment debt stemming from a Chapter 7 debtor's unpaid legal fees was not exempt from discharge under §523(a)(2)(A) of the U.S. Bankruptcy Code.

Debtor Amy Diamond, a Massachusetts resident who managed a group of corporate entities collectively referred to as the "Bandel Group," enlisted Tel Aviv law firm Cassouto-Noff & Co. for assistance in preserving an option to purchase an interest in oil and gas exploration licenses for an area under Israeli control.

During his initial conversation with Diamond, the firm's principal apparently did not discuss the Bandel Group — which he presumed to be a large conglomerate of companies — with the debtor and assumed, based on her statement that "I am Bandel," the debtor would be personally responsible for paying the bills. He also apparently did not realize the option rights were the Bandel entities' sole asset.

When the investment did not pan out, the Bandel entity that held the option rights went bankrupt and Cassouto-Noff could not secure payment for services it had provided.

An Israeli court, piercing the corporate veil, issued a judgment against Diamond personally in the amount of 311,000 Israeli shekels (equivalent to approximately $80,000). The law firm executed on it in Superior Court, which recognized the judgment and which the Supreme Judicial Court affirmed.

When Diamond filed for Chapter 7 bankruptcy, Cassouto-Noff instituted an adversary proceeding, asserting that the debt was nondischargeable as a debt for services obtained by false representation.

But U.S. Bankruptcy Court Judge Elizabeth D. Katz found in Diamond's favor.

"Even if the Debtor misrepresented that she would be personally liable for Cassouto-Noff's legal fees, Cassouto-Noff failed to meet its burden as to actual reliance on this misrepresentation (as opposed to its own assumptions) and failed to counter its assumptions with the knowledge it did have or to inquire further, thereby rendering any reliance not justifiable," Katz wrote, adding that the firm did not establish that Diamond made a promise she knew was false at the time.

The 17-page decision is *In Re: Diamond, Amy F.*, Lawyers Weekly No. 04-001-24.

'INHERENTLY FACTUAL DETERMINATION'

Steven Weiss

Diamond's bankruptcy counsel, Steven Weiss of Springfield, said the ruling reinforces the requirement that a creditor must prove, by a preponderance of the evidence, each prong of a rigor-

ous six-part test to secure an exemption under §523(a)(2)(A).

"In this particular case, the biggest issue was that when my client retained the plaintiff to represent the companies, she fully expected the companies would be successful and be able to pay all the bills," Weiss said. "The fact that the business deal failed doesn't mean the retention of the plaintiff as counsel was fraudulent in some way."

Additionally, Weiss emphasized that the justifiability of Cassouto-Noff's reliance on any representations Diamond may have made was judged under the circumstances, not in a vacuum.

"Objection to the dischargeability of a debt is an inherently factual determination," he said.

Laurence K. Diamond of Wellesley Hills, who represented the creditor, was unable to provide comment before deadline.

But Donald R. Lassman, a bankruptcy lawyer in Needham, said the case shows that a debtor's conduct after a debt is incurred is irrelevant to a §523(a)(2)(A) analysis.

"The law firm kept pointing out that they kept making demands for payments and the debtor never said anything," Lassman said. "But who cares? The representations [being relied on] have to occur before the services are rendered, not afterward."

He also noted that the creditor seemed to be trying to establish the elements of a §523(a)(2)(A) claim based on "its understanding" of the debtor's circumstances.

"But that's not what the test is," Lassman said. "It's not what you understood; it's what the debtor or told you. And the debtor never said, 'You're going to get paid from the assets of all these other [Bendel] companies.' The lawyer assumed in his mind that this 'conglomerate' had all these other assets and could pay, but the debtor never said that. The law firm assumed facts not in evidence."

More broadly, Lassman said, the case illustrates the importance of ensuring that a client's ability to pay is consistent with reality.

"Still, what lawyer enters into an agreement with a client knowing they're going to file for bankruptcy?" he said. "But if you're concerned about their ability to pay, get a retainer."

Boston attorney Thomas H. Curran, who handles creditors' rights and bankruptcy cases, said he was struck that the creditor did not provide evidence on each element of his §523(a)(2)(A) claim.

"That's the death knell," he said. "There's just no wiggle room."

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In Re: Diamond, Amy F.

THE ISSUE: Was a judgment debt stemming from a Chapter 7 debtor's unpaid legal fees exempt from discharge under §523(a)(2)(A) of the U.S. Bankruptcy Code?

DECISION: No (U.S. Bankruptcy Court)

LAWYERS: Steven Weiss of Shatz, Schwartz & Fentin, Springfield (debtor)

Laurence K. Richmond of Richmonds & Co., Wellesley Hills (creditor)

Thomas H. Curran

Curran added that the case had "all the hallmarks" of a difficult claim.

"Both parties were sophisticated, so they're held to a higher level," he said. "If the law firm thought at the very beginning that it was relying on [the debtor] to make payments if the company could not, they should have gotten a personal guaranty and had her sign the contract."

UNPAID FEES

The Bandel Group had an option to buy 8 percent of oil and gas licenses held by a company called ATP East Med Number I.B.V.

The licenses allowed for oil and gas exploration in an area under control of Israel. The option to buy the interest in the licenses was the Bandel entities' only asset.

Diamond, who held executive-level positions with the various Bandel entities, had significant experience in the oil and gas industry as an investment banker, but it was her first opportunity to earn potential profits from production.

In 2011, ATP went into bankruptcy in Israel after drilling operations revealed gas but at a lower than anticipated level. In December 2012, bankruptcy trustees sought to compel the Bandel Group to exercise its option rights in seven days or lose them.

Diamond was referred to Shmulik Cassouto when she needed counsel in Israel to preserve Bandel's option rights.

During an initial phone conversation, Diamond accepted Cassouto's offer to represent the Bandel Group on an hourly basis, and he began rendering legal services.

He apparently opted not to discuss the Bandel Group with the debtor or determine which specific company would pay the fees, allegedly because she stated, "I am Bandel." Cassouto claimed that led him to believe she would be personally responsible.

Diamond and Cassouto continued to communicate by phone and email and met once in person in Israel, in early 2013.

Acting on behalf of the Bandel Group, Diamond signed a written fee agreement.

In late February 2013, the firm sent a bill for services already rendered at that point.

After an Israeli bankruptcy court ruled that the Bandel Group preserved its option rights, the firm sent Diamond another bill a month later.

Despite requests for payment and threats of litigation, the firm's efforts to collect its fees were unsuccessful.

Unable to secure necessary approvals from the Israeli government, the exploration project failed. In 2015, the Bandel entity holding the option rights filed for bankruptcy in Texas.

In October 2015, the law firm secured a default judgment against Diamond personally in a Tel Aviv court.

Several months later, it sought to enforce the judgment in Superior Court under the Massachusetts Uniform Foreign Money-Judgments Recognition Act.

The court recognized the judgment, rejecting Diamond's argument that the Israeli judgment holding her personally liable was repugnant to public policy and ruling that her statements that "she was Bandel" amounted to a personal promise to cover the fees.

In December 2021, Diamond petitioned for Chapter 7 bankruptcy. Cassouto-Noff filed an adversary proceeding seeking a ruling that the judgment debt was nondischargeable under §523(a)(2)(A).

UNMET BURDEN

Following trial, Katz found that Cassouto-Noff did not prove all six elements necessary for a discharge exemption under §523(a)(2)(A).

"Critically, Cassouto-Noff has not argued that it would not have otherwise rendered legal services to the Bandel Group if the Debtor had not agreed to be personally responsible for its legal fees," Katz said. "Consequently, Cassouto-Noff fails to satisfy the fourth element, that it actually relied on the Debtor's promise of personal liability when it provided legal services to the Bandel Group."

To the extent that the firm established actual reliance, Katz continued, Cassouto-Noff did not establish it was justifiable based on any misrepresentation by Diamond.

"Regarding the Debtor's representation that Cassouto-Noff's fees would be paid, Cassouto-Noff failed to establish that the Debtor either knew her promise was false or recklessly disregarded the truth of that promise at the time it was made," Katz said. "Lastly, the Court does not find that the Debtor had an obligation to disclose that the Bandel entities had no books, records, or assets other than the option rights or that she was soliciting investors for the project," Katz wrote.