In the United States Bankruptcy Court

for the Northern District of Iowa

DONNA L. WALDERBACH
aka Donna L. Stratton
Debtor.

Bankruptcy No. L92-00780C

Chapter 7

FIRST BANK SYSTEM, N.A.
Plaintiff

vs.

DONNA L. WALDERBACH
aka Donna L. Stratton
Defendant.

Adversary No. 92-1135LC

ORDER

On August 10, 1993, the above-captioned matter came on for hearing pursuant to assignment. Plaintiff appeared by Attorney Michael J. Burdette. Debtor Donna Walderbach appeared in person with Attorney Mike Mollman. Evidence was presented after which the Court took the matter under advisement.

Plaintiff is a credit card company which commenced this adversary proceeding on July 8, 1992 seeking denial of discharge of a credit card debt incurred by the Debtor. Plaintiff asserts that this debt, in the approximate amount of $2,729.10, should not be discharged because charges against this card were made by Debtor through false pretenses, false representations, or actual fraud, other than a statement respecting the Debtor or insider financial condition under 11 U.S.C. 523.

Debtor Donna Walderbach lives in Cedar Rapids, Iowa. She is married and has two children. In the early 90's, she was employed by Cedar Rapids Dodge in their financing department. She earned approximately $3,100 per month while so employed. She was fired in March 1991. She was then unemployed until March of 1992. During unemployment, she received $744 per month in benefits. She accepted employment at Jim Miller Chevrolet as a finance manager in March, 1992. She was employed there until March of 1993.

Her husband, Lorence Walderbach, is in sales at Grace Lee Products. From March of 1991 until March of 1992, he earned straight commissions of approximately $1,000 to $1,200 per month. In a bad month, he earned as low as $600. Beginning in March of 1992, he was garnished for back child support for four children from a prior marriage. At times, the garnishment was up to 50% of his income. Mr. Walderbach had gross wages of $20,680 for calendar year 1991.

In August of 1991, Debtor received a credit card application from the Plaintiff. It was mailed under Debtor's former name of Donna L. Stratton. It was a postcard application and the only information sought was Debtor's household income. Debtor inserted the amount of $70,000+ as annual household income. Based on the previously discussed

financial information, the parties projected annual income was approximately $21,000.

Debtor testified that she had some debt at the time of filling out the application to the Plaintiff's company. She had other credit cards since the early 1980's. When she returned this application, she had eight to ten other credit cards. The total debt on those cards, at that time, was between $15,000 or $16,000. By the time of the filing of the bankruptcy petition, this debt had increased to $20,000. Minimum payments on the total credit card debts were about $350.00 per month.

Debtor received the credit card and used it twice. One charge was in the amount of $1,176 on February 6, 1992. It's purpose was to pay two mortgage payments on the parties' home. The other charge was made on March 16, 1992 as a $1,600 cash advance which was used to pay household expenses, a car payment, food, clothing, child support, and make minimum payments on other credit card debts. Debtor made one payment of $75 on Plaintiff's card.

Debtor was asked how she calculated the income figure of $70,000+ which was placed on her credit card application. She testified that it was based on her 1990 income tax return when both she and her spouse earned somewhat in excess of $30,000. It appears that the actual gross income on the income tax return for 1990 was less than $65,000. Declared total gross income for 1991 was $43,000 on the parties' tax return.

Debtor testified that she fully intended to repay the credit card debt when the debt was incurred. She stated she anticipated making substantial payments based on tax refunds for the previous calendar year. However, the IRS garnished these tax refunds and they were applied toward child support arrearages. She filed for the tax refund in February of 1992 and it was not until April that she found that they were garnished. Shortly after, she contacted Attorney Mollman and sought bankruptcy advice from him. She filed bankruptcy in April of 1992.

Debtor testified that the card was not used for luxury items but rather for necessities. She testified that it was not until the bankruptcy petition was filed that she made the final determination that she could not repay this obligation. Debtor stated that the decision to take bankruptcy was a difficult one and that she did not intend to run up a credit card debt and not repay the obligation. She felt that when she incurred the debt on this card, she had some ability to repay based on her husband's income and her unemployment checks as well as anticipated income from employment which she hoped to acquire in the immediate future. Her unemployment insurance expired in March of 1992. She found employment sometime thereafter.

ISSUES

The issue for the Court's consideration is whether Plaintiff's claim of approximately $2,729 should be excepted from discharge pursuant to either 11 U.S.C. 523(a)(2)(A) or 11 U.S.C. 523(a)(2)(B).

Two separate allegations of misrepresentation are presented in this case. The first misrepresentation relates to Plaintiff's allegation that Debtor misrepresented her income on the postcard application which was mailed to Plaintiff by Debtor in August of 1991. The second allegation of misrepresentation relates to Plaintiff's claim that in February and March, 1992, Debtor used the credit card in question on two separate occasions when she had neither the ability nor the intention to pay for the charges incurred. The first factual allegation will be analyzed using the elements under 11 U.S.C. 523(a)(2)(B). The second factual allegation will be analyzed using the elements under 11 U.S.C. 523(a)(2)(A).

Credit card obligations are subject to contract law, though the offer and acceptance aspects of credit card law differ somewhat from other types of contracts. The receipt of an application in the mail and the return of the application to the credit card company does not create a contract, nor does the issuance of the credit card by the credit company to the card holder. A credit card holder does not provide consideration for the extension of credit simply by providing information

to the card issuer. The issuance of a card by a credit card company is nothing more than an offer to extend credit. No obligation is imposed upon either the card holder or the card issuer until such time as a purchase is made. It is the use of the credit card which creates the contract whereby the credit card company promises to pay the obligation incurred by use of the credit card. The card holder in return promises that she will pay to the credit card company the charges incurred in this transaction. Garber v. Harris Trust & Savings Bank, 432 N.E.2d 1309 (Ill. App. Ct. 1982). Bankruptcy law has further refined the nature of the promise made by the card holder to the card issuer. Bankruptcy law provides that the use of a credit card constitutes an implied representation to the card issuer that the holder has both the ability and the intention to pay for the charges incurred. In re Stewart, 91 B.R. 489, 495 (Bankr. S.D. Iowa 1989). Therefore, misrepresentation can occur at the beginning of the relationship or impliedly at the time of the use of the card.

SECTION 523(a)(2)(A) CLAIM

Section 523(a)(2)(A) states:

> "A discharge under sec. 727 does not discharge an individual debtor from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by-
>
> (A) false pretenses, a false representa- tion, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

Courts use a five part test which must be satisfied before a debt will be excepted from discharge under 523(a)(2)(A). The elements are: (1) the debtor made false representations; (2) the debtor knew the representations were false at the time they were made; (3) the debtor made the representations with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representations; In re Ophaug, 827 F.2d 340, 343 (8th Cir. 1987), and (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. In re Coates, No. L-90-00780C (Bankr. N.D. Iowa Apr. 1, 1991); In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987). These elements must be proven by a preponderance of the evidence. Grogan v. Garner, 111 S. Ct. 654, 659 (1991).

Plaintiff's claim under 11 U.S.C. 523(a)(2)(A) relates to usage of the card on two occasions. Bankruptcy law provides that implied misrepresentation occurs if a credit card holder uses a credit card when he or she knows that they neither have the ability nor the intention to pay for the charges which are incurred. As indicated, use of a credit card creates a contract which raises an implied representation as to the ability and the intention to pay the charges incurred. In re Stewart, 91 B.R. 489 (Bankr. S.D. Iowa 1989). Once the law implies a representation as to the ability and the intention to pay by a card holder, the first three elements of the test under 523(a)(2)(A) all interlock and are resolved either affirmatively or negatively based upon the Court's determination as to the ability of the card holder to pay and the intention of the card holder to pay for the charges incurred.

It is the conclusion of this Court that at the time the two credit card charges were made, Debtor did not have any reasonable ability to pay for the charges. The charges were made in February and March of 1992. At that time, Debtor was unemployed and collecting $744 per month in unemployment benefits. Her husband was employed and earning, at a maximum, approximately $1,200 per month. Also by this time, Debtor's husband was being garnished for back child support. On occasion, this garnishment totaled 50% of his income. The Debtor had eight to ten additional credit cards with a debt load, at that time, of between $16,000 and $20,000. The monthly minimum payment on these cards was in excess of $350. Debtor testified that one of the primary reasons for acquiring this credit card was to help pay off some of these other obligations. It is the conclusion of this Court that, at the time the charges were made against this card, Debtor was not reasonably able to pay.

The Debtor's intent is the most critical element of the entire analysis. In assessing intent, most Courts, including the Northern and Southern Districts of Iowa, have adopted a totality of the circumstances approach based on a number of

factors. In re Davis, No. X91-01771F, slip op. at 7 (Bankr. N.D. Iowa Aug. 21, 1992); In re Stewart, 91 B.R. 489, 495 (Bankr. S.D. Iowa 1989). These factors include but are not limited to: (1) the length of time between the charges and the bankruptcy filing; (2) whether the debtor consulted an attorney about filing bankruptcy before the debtor made the charges; (3) the number of the charges made; (4) the amount of the charges; (5) the financial condition of the debtor at the time of the charges; (6) whether the charges exceed the limit on the account; (7) whether the debtor made multiple charges on one day; (8) whether the debtor was employed; (9) what the debtor's prospects were for employment; (10) the debtor's financial sophistication; (11) whether there was a sudden change in the debtor's buying habits; and (12) whether the debtor purchased luxuries or necessities. Davis, slip op. at 7.

There is no mathematical requirement in applying these factors and no requirement that a minimum number of factors be present in order to find the requisite intent. Courts, on occasion, have found intent based solely on the single factor that the Debtor had no realistic prospect of repaying the indebtedness. See e.g., Davis, slip op. at 7.

Although not all of the factors are present in this case, many have applicability. The Court will not discuss each numbered factor separately but will make general reference to those factors which appear to apply.

Debtor received this credit card application in August of 1991. A considerable period of time elapsed without any charges being made against the card. Then in February, and again in March, two substantial charges were made against the account; the last of which was made less than one month prior to the bankruptcy petition being filed. Although the number of charges made against the account were numerically small, both charges which were made were in excess of $1,000.

The Court has already discussed the financial condition of the Debtor at the time of the making of these charges. However, it is noted that, at the time of the making of the charges, the Debtor was unemployed. She was receiving unemployment benefits. The record does not reflect any reasonable possibility of immediate gainful employment at that time. The Debtor and her husband were in dire financial straights. Mr. Walderbach was employed, however, his income was being substantially garnished for child support arrearages.

It is clear that Debtor understood the nature of these transactions. She testified that she understood the amount of credit card debt which she and her husband had incurred on other credit cards. She testified that one reason for acquiring this card was, in effect, to make this credit card a debt consolidation loan. The specific purpose was to allow charges to be made on this card to pay running expenses on other debts and other credit cards.

Finally, while many cases discuss the purchase of luxury items as an indicator of intent not to pay, the purchase of necessities in this case is an indication of such intent. In analyzing this factor, the Court recognizes what may be construed as unfairness using both the purchase of luxuries and the purchase of necessities as indication of intent. In this case, Debtor made one charge against this credit card for the specific purpose of paying two house payments which were in arrears. The second charge was made, at least in part, to pay child support which was in arrears as well as other indebtedness of the parties. These expenditures were not for the purchase of clothing or necessary household goods.

It is the feeling of this Court that these expenses were incurred because Debtor's financial situation had reached such a state that she could not meet her day-to-day obligations. Debtor was relying upon credit cards to pay these necessary obligations when she neither had the ability nor the intention to repay them. She is not financially unsophisticated. She was employed at various occupations for a considerable number of years as a finance manager. It is obvious, from the record made as well as from her past employment, that she understands the nature of credit and the transactions which occurred in this case.

Ultimately, it is the conclusion of this Court that Debtor's financial condition, as well as the consideration of the factors, taken together, establish that, at the time of the creation of these charges, Debtor did not have a reasonable ability to repay them. Additionally, it is the ultimate conclusion of this Court that based upon the legal criteria of In re Stewart, 90 B.R. 489 (Bankr. S.D. Iowa 1989), Debtor did not possess the requisite intent to repay these obligations at the time they were incurred.

Two final elements exist in a nondischargeability claim under 523(a)(2)(A). These are that the creditor relied upon these implied representations and, finally, that the creditor sustained the alleged injury as a proximate result of these representations. Based on the Court's prior findings in this regard, it is the Court's determination that Plaintiff did sustain a loss of $2,776 because of the two charges made. These losses were caused by the implied representations made by Debtor. For all of the reasons set forth in this opinion, it is the conclusion of this Court that the Plaintiff has met its burden of proof in establishing a claim of nondischargeability under 523(a)(2)(A).

SECTION 523(a)(2)(B) CLAIM

Sec. 523(a)(2)(B) states:

> "A discharge under section 727 does not discharge an individual debtor from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by-
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> (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 to be published with intent to deceive."

The elements of proof for this provision require that: (1) the false financial statement be a writing respecting the debtor's financial condition; (2) the financial statement be materially false; (3) the debtor intended to deceive; and (4) there be reliance on the part of the creditor. In re Mutschler, 45 B.R. 482, 490 (Bankr. D.N.D. 1984).

The first element of this claim requires that there be a financial statement and that it be in writing respecting the Debtor's financial condition. In the present case, the financial statement consists of the postcard application which was filled out by Debtor and returned to Plaintiff. It is the conclusion of this Court that the figure of $70,000+ placed on this application does constitute a financial statement relative to household income and was a writing which reflected Debtor's financial condition. As such, the first element of this claim is established by a preponderance of evidence.

The second element requires that the financial statement be materially false. In filling out the credit card application, Debtor represented that the household income, for her and her family on an annual basis, was in excess of $70,000. Debtor testified at trial that this figure was based upon income generated in 1990. However, the record also reflects that in 1990, both parties were working and earning somewhat in excess of $30,000. Nevertheless, even at that time, which is apparently the parties' most productive year, their income was substantially less than $70,000. At the time of the filling out of the application, Debtor's financial picture had deteriorated substantially. During 1991, Debtor had lost her employment and was receiving unemployment compensation. Her husband was earning approximately $1,200 per month with periods of employment dropping substantially below those figures. The income figures presented to the Court would project an annual income of approximately $21,000 or $22,000.

Courts have determined that a "materially false statement" for purposes of 523(a)(2)(B) is one which paints a substantially untruthful picture of a financial condition by misrepresenting information of the type which would normally affect the decision to grant credit. Mutschler, 45 B.R. at 491. It is the conclusion of this Court that Debtor did make a false representation to the credit card company regarding her annual household income at the time of the return of the application. There is no doubt that Debtor knew that this representation was false at the time it was made. There does not appear to be any period of time represented to the Court when the household income of Debtor was in excess of $70,000. In light of the definition of materiality, this misstatement of income by Debtor is material since it is of the type which would normally affect the decision to grant credit. In fact, the misstatement addressed the only question which the creditor asked relative to financial information. As such, it is the conclusion of this Court that Plaintiff has established this element by a preponderance of evidence.

Next, Plaintiff must establish that Debtor intended to deceive. In addressing this issue, the Courts have stated that intent can be gleaned from surrounding circumstances. Courts have considered certain indicia, such as whether there was a clear pattern of purposeful conduct and whether the Debtor was intelligent and had experience in financial matters. Ordinarily, the mere fact that a statement is false, and that Debtor knew it was false, has been held not to be ultimately determinative of the intent to deceive. In re Mutschler, 45 B.R. 482 (Bankr. D.N.D. 1984). While the evidence does not establish a pattern of purposeful conduct, the record does clearly establish Debtor is a person familiar with financial matters and who has had substantial experience in her employment in dealing with financial applications and other types of financial matters. It is appears to this Court that the only rational reason why a Debtor would represent substantially inflated income figures, knowing them to be false, would be to improve the chances of approval of the application for a credit card and to achieve an initially higher credit limit. Otherwise, no practical purpose would be served by intentionally overstating these figures such as was done in this case. It is the conclusion of this Court that Plaintiff has established, by a preponderance of evidence, that Debtor did intend to deceive the credit card company through the use of these inflated financial numbers.

Finally, Plaintiff must establish that there was reliance on the part of the creditor. The Court concludes that the evidence does establish that Plaintiff did rely upon these representations. It was the testimony of Plaintiff that the income stated in the application does have an impact upon whether a credit card application is approved or not and, if approved, the amount of the credit limit. It is the ultimate finding of this Court that the credit card company sustained this loss based upon the issuance of the card which, in turn, was approved based upon the representation of a household income in excess of $70,000.

It is the ultimate conclusion of this Court that Plaintiff has sustained its burden of proof by a preponderance of evidence establishing that this claim should be excepted from discharge under 523(a)(2)(B).

WHEREFORE, for all the reasons set forth herein, it is the finding of this Court that Plaintiff has established by a preponderance of evidence its claim under 523(a)(2)(A) thereby precluding discharge of this claim in bankruptcy.

FURTHER, it is the finding of this Court, for all of the reasons set forth herein, that Plaintiff has established by a preponderance of evidence, its claim under 11 U.S.C. 523(a)(2)(B) thereby excepting its claim from discharge.

FURTHER, the total claim of $2,729 plus interest and costs accrued because of this claim is excepted from discharge and will not be discharged with the other indebtedness.

SO ORDERED this 31st day of August, 1993.

Paul J. Kilburg, Judge
U.S. Bankruptcy Court