

In the United States Bankruptcy Court  
for the Northern District of Iowa

SHERRILIE M. MILLER <i>Debtor(s).</i>	Bankruptcy No. 96-62499-W Chapter 7
AT&T UNIVERSAL CARD SERVICES <i>Plaintiff(s)</i>	Adversary No. 97-9007-W
vs.	
SHERRILIE M. MILLER <i>Defendant(s)</i>	

ORDER RE DISCHARGEABILITY

This matter came on for trial pursuant to assignment on April 14, 1998. Plaintiff AT&T Universal Card Services was represented by Attorney Mark Reed. Debtor/Defendant Sherrilie M. Miller was represented by Attorney Michael Dunbar. After the presentation of evidence and argument, the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

AT&T issued Debtor a credit card. Several months before filing her Chapter 7 petition, Debtor incurred one charge and two cash advances within two days totaling \$4,436.35. AT&T asserts its claim should be excepted from discharge under §523(a)(2)(A) as arising from Debtor's false representations of her ability and intent to repay. Debtor denies making any misrepresentations and requests attorney fees and costs under §523(d).

FINDINGS OF FACT

AT&T sent Debtor an unsolicited, preapproved credit card application. She responded by telephone and her account was opened in December 1994 with a \$2,000 credit limit. In February 1995, AT&T granted Debtor's request to increase the credit limit to \$4,000. Debtor expressed an intent to consolidate other debts by using balance transfer checks issued by AT&T. Debtor also communicated with AT&T on January 18, 1996, reporting a change of address to occur in February and requesting AT&T replace her card which she had lost.

On January 27, 1996 when the account had a zero balance, Debtor made a credit card purchase of \$56.13 and took a cash advance of \$500. Two days later, Debtor took another cash advance on the credit card of \$3,800. The total of these amounts exceeded her \$4,000 credit limit. She made one payment of \$75.00, less than the minimum payment required, in March and filed her Chapter 7 petition on October 1, 1996. It is this debt that AT&T seeks to except from discharge under §523(a)(2)(A).

Ronald Lewis, a senior bankruptcy recovery litigation specialist, testified for AT&T, his employer. He stated that potential card holders are pre-screened before AT&T sends preapproved account applications. The credit check is a six-month process, with the applicant's 24-month past credit history being a critical factor. AT&T utilizes a "FICO" score set by the credit bureau to determine the potential card holder's financial fitness. It requires a FICO score of 680 for

individuals to qualify for credit card accounts. Debtor's score at the time of her application was 714.

Mr. Lewis testified that telephone applications seek information such as yearly earnings, date of birth, social security number, address, etc. He stated that eligibility for the credit card account requires an annual income of \$15,000. It is AT&T's practice to rely on the customer's word regarding annual income without making an independent inquiry. After an account is opened, AT&T monitors the account quarterly, reviewing credit bureau information. Such reviews of Debtor's account indicate a continuing FICO score similar to her initial score.

After Debtor incurred the debt at issue in late January, 1996, Debtor did not communicate with AT&T until June 15, 1996. At that time, she informed AT&T that she was unemployed, disabled and unable to pay. Debtor did not inform AT&T that she was receiving alimony or was divorced. She did disclose that she would begin receiving \$300 per month for Social Security disability payments in July and advised AT&T of her medical problems.

In May, 1996, AT&T placed a skip trace on Debtor to determine her whereabouts. Debtor had changed addresses around that time. Mr. Lewis testified that he believed Debtor was purposefully trying to avoid AT&T. AT&T had made phone calls to Debtor. The person answering the phone denied being the card holder, but Mr. Lewis believed it was actually Debtor.

Mr. Lewis testified that, in his opinion, Debtor did not have the ability to pay her credit card account balance. He stated that AT&T would not have extended credit to Debtor if they had known of her inability to pay. It is Mr. Lewis' opinion that Debtor committed fraud based on the following circumstances: 1) the amount of the cash withdrawals, 2) the following minimal payment, 3) Debtor hid and had to be skip traced, 4) Debtor did not disclose her social security or alimony payments until after she charged up her account, 5) Debtor's other credit card accounts had large balances at the same time, 6) Debtor appeared to be using her husband's income to obtain credit, 7) the ratio of her income to her credit card balance and 8) the fact that she had seven credit card accounts with a cumulative total balance of \$22,000 at the time she filed her Chapter 7 petition. Mr. Lewis stated that the fact that Debtor had several other credit card accounts with substantial balances which seemed to go bad at the same time indicates potential kiting between the accounts.

Mr. Lewis further testified that AT&T encourages cardholders to consolidate debt on AT&T's credit card. He stated AT&T increased Debtor's credit limit on her request and based on her good credit history. Mr. Lewis conceded that Debtor's health problems could explain her delinquency in making payments. Debtor did not inform AT&T of her health problems, however, until June 1996. AT&T relies on a clearinghouse, Wallace & DeMayo, to review a cardholder's account in investigating fraud under §523(a)(2)(A). Mr. Lewis testified that local counsel can also make an independent investigation regarding whether a complaint should be filed.

Debtor is 56 years of age and single. She was previously married to Delbert Miller. She filed a petition for dissolution in October 1994 which became final in March 1995. She left the marital home in November 1994, intending to get a job. While she was married, Debtor relied on her husband's income to pay creditors and she received an allowance from him every week. Debtor's husband mainly paid the couple's running expenses.

Debtor has not been employed full-time since 1985. She has been seeing a psychiatrist since 1983 for emotional problems. In 1995, she worked part-time as a cashier at Payless Cashways from August to November, received alimony and social security disability payments and made and sold crafts. Debtor was not able to return to work in January 1996 when Payless called her back because of her poor health, including intestinal problems and high blood pressure.

Debtor had a nervous breakdown after her ex-husband attempted to commit suicide. She receives social security disability payments. She moved to her present address in February 1996. Debtor's bankruptcy schedules list seven credit card companies as unsecured creditors. She had more accounts previously which she paid off. Her total credit card debt may have been up to \$30,000 in 1996.

From the cash advances she received from her account with AT&T in late January, 1996, Debtor paid \$500 to her father because the motor went out on her car. She used some of the \$3,800 cash advance to consolidate other debt to Bank of America, Visa and Younkers, and to help her move to a different apartment. Some of the money went to her landlord and some went for utility payments. Debtor testified that she only paid \$75.00 to AT&T after the cash advances because she failed to receive a statement from AT&T after her move to a different apartment. Debtor was under the impression

that her credit limit was \$5,000, not \$4,000.

Debtor first visited with her attorney in March 1996 concerning filing a petition in bankruptcy. Her subsequent attempts to avoid bankruptcy by getting loans from her father or financial institutions failed. One bank employee advised her that using her credit card to pay off debt was the way to go because the interest rate would be lower. She testified that she never tried to avoid or hide from creditors. Debtor stated that when she took the cash advances in January 1996, she had no intention of filing for bankruptcy relief. She testified that she had planned to go back to work and fought with her doctor to do so, but finally conceded she could not work because of her poor health. She applied to the dissolution court for increased alimony which has been granted.

The record contains copies of interrogatory answers concerning Debtor's gambling activities. Debtor admits that gambling is not a reasonable way to incur income to pay off debts. AT&T did not elicit any testimony from Debtor at the trial regarding gambling.

**CONCLUSIONS OF LAW**

AT&T asserts its claim is nondischargeable under

§ 523(a)(2)(A). Section 523(a)(2)(A) excepts a debt from discharge if it is obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." A five part test 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 justifiably relied on the representations, Field v. Mans, 116 S. Ct. 437, 446 (1995); and (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987). AT&T must prove the elements of §§523(a)(2)(A) by a preponderance of the evidence. Grogan v. Garner, 111 S. Ct. 654, 659 (1991).

**DISCHARGEABILITY OF CREDIT CARD DEBT**

Bankruptcy law provides that the use of a credit card constitutes an implied representation to the card issuer that the cardholder has both the ability and the intention to pay the charges incurred. In re Anastas, 94 F.3d 1280, 1285 (9th Cir. 1996); In re Stewart, 91 B.R. 489, 495 (Bankr. S.D. Iowa 1989); In re Weiss, 139 B.R. 928, 929 (Bankr. D.S.D. 1992). Once the law implies this representation, the first three elements of the test under §523(a)(2)(A) interlock. In credit card debt, the first three elements of nondischargeability for fraud are met by a determination by the Court that the Debtor did not have the ability or intention to pay the charges incurred.

Debtor's intent is the most critical element of the entire analysis. Direct evidence of intent is rarely available; intent may be proved by circumstantial evidence. In re Eashai, 87 F.3d 1082, 1090 (9th Cir. 1996). In assessing intent, most courts, including the courts in the Northern and Southern Districts of Iowa, have adopted a totality of the circumstances approach based on a number of factors. In re Feldhacker, Adv. No. 96-5119XS, slip op. at 8 (Bankr. N.D. Iowa Sept. 5, 1997) (citing First Deposit National Bank v. Coates (In re Coates), Adv. No. L-90-0137C, (Bankr. N.D. Iowa April 1, 1991)); Stewart, 91 B.R. at 495. 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. Coates, slip op. at 7; Eashai, 87 F.3d at 1090.

In In re Carrier, 181 B.R. 742, 745 (Bankr. S.D.N.Y. 1995), the debtor was in poor financial condition, recently divorced and worked only part-time. The court found that the 12-factor test focused on the timing of the charges and the debtor's financial condition. Id. at 746. The debtor was not overly sophisticated financially and had a naive, but

reasonable, expectation of pursuing a new career, which did not come to fruition. Id. at 748. The court found the debtor did not have an intent to deceive under §523(a)(2)(A). Id. Another court found that a debtor, although hopelessly insolvent, did not realize that fact and hoped to take care of financial problems with additional employment. In re McDaniel, 202 B.R. 74, 79 (Bankr. N.D. Tex. 1996). It found that under the totality of the circumstances the debtor had no intent to defraud the credit card issuer. Id. In In re Mack, 216 B.R. 981, 982 (Bankr. N.D. Fla. 1997), the court noted that the debtor wife was a stay-at-home mom and the debtor husband earned the family's income and handled all the family's finances. Finding that the debtor wife was anything but financially sophisticated, the court held that her credit card debt was not nondischargeable under §523(a)(2)(A). Id. at 984. She had believed her husband was paying the bills and when she knew of their financial difficulties she stopped charging. Id.

Under the 12-factor test relating to intent under §523(a)(2)(A) in this case, the following circumstances tend to prove Debtor had no intent to defraud. Debtor made the charges on January 27 and 29, 1996. She filed her Chapter 7 petition on October 1, 1996, more than 9 months later. She did not make any charges after first consulting with a bankruptcy attorney in March 1996. She made one charge and a cash advance on January 27 and one cash advance on January 29, totaling \$4,436.35. The charges on Debtor's account with AT&T exceeded the \$4,000 credit limit. Debtor testified, however, that she believed her credit limit to be \$5,000. Debtor used most of the advances to repair her car, for living expenses relating to moving to a different apartment, and to pay off other charge accounts. The record does not prove Debtor used the advances for luxuries or gambling.

The following circumstances point to possible intent to defraud under the 12-factor test. At the time she made the charges, Debtor's financial condition was poor. Debtor's total credit card debt may have been \$30,000. In late January, 1996, Debtor had just completed dissolution proceedings, she could not return to her part-time job because of her health, and her only income was minimal alimony and social security disability payments. She was fighting with her doctor to return to work and hoped to find employment. The Court will assume that taking two hefty cash advances was a change from Debtor's charging habits.

In this case, the Court feels that Debtor's lack of financial sophistication is an important factor in determining intent to defraud. Debtor had not worked full-time for more than a decade. She was under a psychiatrist's care and in poor physical health. Debtor's husband handled the couple's finances while they were married and she relied on his income. Debtor testified that she truly believed she had the ability to maintain monthly payments on her credit card debt. Although the record shows Debtor was insolvent and unable to earn the necessary income to make minimum monthly payments, this was not apparent to Debtor at the time.

The Court concludes AT&T has failed its burden to prove Debtor's intent to defraud. At the time Debtor made the charges, she was acting under the mistaken, but sincere, impression that she would be able to make required payments. Applying the 12-factor test for intent under §523(a)(2)(A) to the totality of circumstances in this case requires the conclusion that Debtor did not have the intent to defraud AT&T.

**ATTORNEY FEES, §523(d)**

Debtor asserts that she is entitled to attorney fees and costs under §523(d). That section provides that if a creditor requests a determination of dischargeability and the debt is discharged,

the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. §523(d). In order to be "substantially justified", the complaint must have a reasonable basis in law and fact in light of the factors relevant to the claim of nondischargeability. FCC Nat'l Bank v. Dobbins, 151 B.R. 509, 512 (W.D. Mo. 1992). A creditor is not substantially justified when it proceeds to trial knowing that it lacks sufficient evidence to sustain its burden of proof and then fails to establish a single necessary element of its claim. Manufacturers Hanover Trust Co. v. Hudgins, 72 B.R. 214, 220 (N.D. Ill. 1987). The stated purpose for §523(d) is to discourage creditors from commencing actions in an effort to obtain a settlement from an honest debtor who may not be able to pay for an attorney to handle an adversary proceeding. Stewart, 91 B.R. at 497.

A finding of substantial justification under § 523(d) is made upon the facts peculiar to each case. The Court is concerned that AT&T did not show that it made any specific investigation into Debtor's circumstances prior to filing its dischargeability complaint. Many of the factors relevant to prove intent to defraud point toward Debtor's lack of intent. The two cash advances and one charge were made several months prior to the time Debtor filed her Chapter 7 petition. AT&T did not offer any evidence that Debtor used the advances for anything other than living expenses. AT&T made no effort to confirm Debtor's income at the time she applied for the credit card or anytime thereafter. It alleges Debtor had a gambling problem and engaged in a credit card kiting scheme. No evidence was presented supporting the kiting scenario and the only evidence of gambling arises from interrogatory answers presented as exhibits.

In these circumstances, the Court concludes that AT&T was not substantially justified in bringing its dischargeability complaint. No special circumstances exist which would make an award of costs and fees under §523(d) unjust. AT&T is a large financial institution and a repeat player in bankruptcy proceedings across the country. Debtor is entitled to costs and fees under §523(d).

WHEREFORE, AT&T Universal Card Services' Complaint to Determine Dischargeability under §523(a)(2)(A) is DENIED.

FURTHER, AT&T's claim is dischargeable.

FURTHER, Debtor is entitled to costs and fees under §523(d).

SO ORDERED this 12th day of May, 1998.

Paul J. Kilburg  
U.S. Bankruptcy Judge