

In the United States Bankruptcy Court

for the Northern District of Iowa

JONI L. WALKER

Bankruptcy No. 98-00905-W

Debtor(s).

Chapter 7

UNIVERSAL BANK N.A.

Adversary No. 98-9117-W

Plaintiff(s)

vs.

JONI L. WALKER

Defendant(s)

ORDER

This matter came before the undersigned for trial on November 18, 1999 pursuant to assignment. Plaintiff Universal Bank, N.A. was represented by attorney Mark Reed. Debtor/Defendant Joni L. Walker was represented by attorney Paul Demro. 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

Universal Bank holds a claim against Debtor for credit card debt. It seeks to except its claim from discharge for fraud. Debtor denies she had the intent to defraud when she incurred the credit card charges.

FINDINGS OF FACT

The credit relationship between Universal Bank and Debtor began when Debtor received an unsolicited offer to open a credit card account. She opened her original account in September 1991 with a credit limit of \$1,000. The current account, with a \$3,000 credit limit, was opened in November 1995. From that time until the middle of 1997, Debtor generally paid off the entire account balance monthly. Most monthly statements show one or more cash advances from the Mesquaki or Diamond J casinos. In September 1997, Debtor started making smaller payments. She continued to take cash advances at the casinos, as she had in the past, and the advances gradually increased in number and amount.

According to the February 21, 1998 statement from Universal Bank, Debtor took four cash advances totaling \$756.96 during that monthly billing cycle. Until September 1997, charges on Debtor's account averaged between \$200 to \$300 per month, including casino cash advances. Debtor's final payment on the account was in the amount of \$40.00 paid on January 16, 1998 and her final charge

was on February 24, 1998 with a cash advance from Mesquaki Bingo of \$214.99. Debtor became past due in payments on the account in February 1998 and exceeded her credit limit by \$20 with her last cash advance. Debtor testified that she first met with an attorney about filing for bankruptcy on March 1, 1998. She signed her petition on March 24, 1998 and filed her Chapter 7 petition on April 1, 1998.

Since 1995, Debtor has earned gross income of approximately \$5,000 to \$5,500 per year. In October 1996, Debtor inherited \$10,000 and the house where she currently resides. Her house is currently free of debt. Debtor had help from a housemate paying household bills until they separated in February 1998. At approximately the same time, Debtor's work week was cut from five days to two days. The \$10,000 Debtor inherited was fully spent by January 1998.

Debtor received unemployment payments when her work hours were reduced in February 1998 and after she finally lost her job in July 1998. Debtor is currently receiving Supplement Security income benefits for disability. A December 2, 1998 decision by an Administrative Law Judge concludes that Debtor was disabled from the time that she filed her initial request for disability payments in September 1997.

Debtor has made monthly trips to Tama and Dubuque to gamble. She testified that she took money from cash advances at the casinos to pay household bills and help her children and grandchildren with food and clothes. She testified that when she was incurring the charges she intended to pay them back. Debtor believed she could pay her bills until her health deteriorated to the extent that she could no longer work.

Debtor has suffered from pancreatitis for more than 20 years, since she was 17 years old. At times, she is hospitalized for her condition. Debtor testified she didn't know at the end of 1997 how bad her health would get and hoped it would improve. In the past, Debtor has worked in a day care, sold lawnmowers and worked cleaning out kennels at the animal shelter. Her health and attendant absences were the cause of her reduced hours and subsequent termination of employment at the animal shelter.

Ronald Lewis testified for Universal Bank where he is employed as a bankruptcy specialist. Universal Bank relies on a "FICO" score to determine credit stability of debtors. Mr. Lewis testified that Debtor's FICO score stayed high until within a month of her bankruptcy filing. On a scale of a low of 300 to a high of 900, Universal Bank requires a minimum score of 680 for an applicant to qualify for a credit card account. Debtor's FICO score was 775 when she opened her credit card account. Mr. Lewis testified he is not knowledgeable about the type of information used to determine a FICO score, or what factors are considered relevant or the weight given to each factor. He stated he did not know whether debtors' income levels were considered in determining their FICO scores.

Mr. Lewis testified that most of Debtor's charges were cash advances to casinos, usually one or two a month. Debtor also used a convenience check to pay real estate taxes to the Blackhawk County Treasurer. Debtor paid off her account balance in full in May 1997 and August 1997. The Bank tried to contact Debtor in January 1998. Debtor promised to pay on the account at that time. Mr. Lewis testified that Universal Bank considers Debtor to be financially sophisticated based on her ability to service her debts and to maintain checking and savings accounts.

CONCLUSIONS OF LAW

Universal Bank 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." Five elements 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, 516 U.S. 59, 72 (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). Most credit card cases turn on whether the debtor misrepresented the intent to repay and whether the creditor justifiably relied on that representation. In re Ellingsworth, 212 B.R. 326, 332-33 (Bankr. W.D. Mo. 1997). Universal Bank must prove the elements of §§523(a)(2)(A) by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 290 (1991).

INTENT TO REPAY

Bankruptcy law provides that the use of a credit card constitutes an implied representation to the card issuer that the cardholder has 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 §523(a)(2)(A) test interlock. In credit card debt, the first three elements of nondischargeability for fraud are met by showing that the debtor did not have the intent to repay the charges incurred. In re McVicker, 234 B.R. 732, 737 (Bankr. E.D. Ark. 1999).

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); Stewart, 91 B.R. at 495; Eashai, 87 F.3d at 1090. 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. McVicker, 234 B.R. at 737.

To determine the applicability of §523(a)(2)(A), the Court must evaluate the subjective intent of the debtor. Citibank, N.A. v. Michel, 220 B.R. 603, 606 (N.D. Ill. 1998). There is no fraud when a person makes a representation and sincerely believes it to be true. Id. The court must consider objective evidence in addition to considering the debtor's demeanor. Id. Evidence of significant life events precipitating bankruptcy have been considered in determining the sincerity of a debtor's intent to repay under §523(a)(2)(A). See In re Cron, 241 B.R. 1, 9 (Bankr. S. D. Iowa 1999) (considering unanticipated reduction of overtime and responsibility for grandson's care); In re Arroyo, 205 B.R. 984, 986 (Bankr. S.D. Fla. 1997) (noting protracted dissolution of marriage and subsequent heart attack prepetition were significant); In re Valdes, 188 B.R. 533, 539 (Bankr. D. Md. 1995) (considering debtor's undisputed and credible testimony regarding unexpected medical expenses and unforeseen expense for automobile repairs); In re Leonard, 158 B.R. 839, 845 (Bankr. D. Colo. 1993) (including in totality of the circumstances the debtors' unexpected and chronic medical problems).

Debtor incurred about \$1,000 of the \$3,000 credit card debt approximately one to two months prior to Debtor filing her Chapter 7 petition. Debtor had not consulted an attorney about bankruptcy before these final charges. Neither the number of the final cash advances (five over six weeks) nor the

amount (approximately \$1,000) prove that Debtor intended to charge up the account and steal credit from Universal Bank before filing for bankruptcy relief. The charges did not exceed the credit limit and Debtor did not make multiple charges on one day. Debtor was taking cash advances on her gambling trips and using at least part of the advances for necessary household expenses, as she had done in the past.

A series of misfortunes befell Debtor in late 1997 and early 1998. Her health deteriorated, caused by her chronic pancreatitis. Her housemate moved out, increasing her responsibility for paying household expenses. Her job was cut from five to two days a week. The nest egg she received as an inheritance was finally depleted. Debtor hoped she would regain her health and be able to work full time again. Instead, she soon qualified for disability income.

Viewing the totality of the circumstances, the Court concludes Universal Bank has failed to prove Debtor intended to defraud at the time she made her credit card purchases. Debtor did not engage in a spending spree in anticipation of gaining a bankruptcy discharge. Her accelerated use of cash advances is more attributable to sudden exaggeration of her problems than to an intent to run up charges in anticipation of a bankruptcy discharge. See In re Stearns, ___ B.R. ___, 1999 WL 1100873, at *12 (D. Minn. Nov. 26, 1999). Debtor convinced the Court she hoped that her health would improve and that she could continue making payments as she had in the past.

JUSTIFIABLE RELIANCE

The Supreme Court in Field v. Mans, 516 U.S. 59, 72 (1995), held that §523(a)(2)(A) requires justifiable reliance. The Court notes: "Justification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than the application of a community standard of conduct to all cases." Id. at 70. In In re Feld, 203 B.R. 360, 370 (Bankr. E.D. Pa. 1996), the court considered justifiable reliance in the credit card context. The court concluded that the Supreme Court in Field implicitly accepts as justifiable the extension of credit where the card use does not send up any red flags. Id.

Thus, following an initial credit check that uncovers no problems, if a cardholder's use is consistent with past use, and the cardholder is paying the minimum charge and staying within credit limits, reliance on the cardholder's implied representation of intent to repay will generally be justifiable.

Id.

Credit card companies' use of FICO scoring has been examined by courts in the context of determining justifiable reliance. This Court in In re Field, Adv. No. 98-9079M, slip op. at 12-13 (Bankr. N.D. Iowa Apr. 28, 1999), found reliance on the FICO credit score was not sufficient to meet the §523(a)(2)(A) requirement of justifiable reliance. Universal Bank was also the plaintiff in that action. The Court stated:

Universal based its reliance primarily on a credit score. Since there was no evidence as to what the criteria were or what the credit score was meant to predict, Universal has offered no basis for finding it was justified in relying on the credit score. Moreover, a credit score is based on a person's credit bureau file, which is an incomplete picture of the person's financial condition. Credit bureau records do not contain income information. The records depend for information on reporting by others and may not be current.

Id. at 12-13 (citations omitted).

In In re Akins, 235 B.R. 866, 874 (Bankr. W.D. Tex. 1999), the court described the FICO credit scoring system as follows:

It is the credit card companies that have created the system whereby they each submit information to the credit reporting agencies and then turn around and use a compilation thereof to determine a person's creditworthiness. The accuracy of the information they get back depends on the accuracy of the information they put in. . . . The credit card companies are living in a dream world.

The court in In re Nguyen, 235 B.R. 76, 90 (Bankr. N.D. Cal. 1999), found using a FICO score does not demonstrate justifiable reliance because of the limitations of the FICO methodology. The FICO score reflects whether a debtor is handling credit properly and has no negative credit history. Id. at 80. It does not reveal the amount of debt the person has handled, or reflect information on the debtor's income or assets. Id. at 81. Likewise, the complaining creditor in In re Kountry Korner Store, 221 B.R. 265, 268 (Bankr. N.D. Okla. 1998), based its decision to offer an unsolicited credit line solely on a score generated from information from credit reporting agencies. The court found the creditor must expect, and assume the risk of, a certain rate of default when adopting a marketing strategy that allows credit to be offered without an investigation of potential customers' present financial condition. Id. at 274.

"[A] creditor who extends credit without proper investigation is not entitled to a judgment of nondischargeability." Id., quoting In re Kaspar, 125 F.3d 1358, 1362 (10th Cir. 1997). The court in In re Mercer, 220 B.R. 315, 326-27 (Bankr. S.D. Miss. 1998), also outlined the FICO scoring process and concluded that the creditor, which solely relied on its own investigative process to make the decision to grant credit, failed to establish reliance on any representation by the debtor. See also, Stearns, ___ B.R. ___, 1999 WL 1100873, at *13 (noting that a FICO score is not a representation made by the customer; the creditor failed to prove both actual and justifiable reliance on a fraudulent representation by the debtor); In re Ellingsworth, 212 B.R. 326, 338-39 (Bankr. W.D. Mo. 1997) (stating creditor does not justifiably rely on any representation from the debtor if the card was pre-approved and no direct financial information of the debtor was obtained).⁽¹⁾

Based on the foregoing, the Court concludes Universal Bank has failed to show by a preponderance of the evidence that it justifiably relied on any misrepresentation by Debtor. Universal Bank did not offer any evidence that it ever inquired into Debtor's financial status, her assets, her total debt or her income, either at the time it pre-approved her credit card account or anytime thereafter.

The only indication the Court has of Universal Bank's information about Debtor's income is on page 11 of Plaintiff's Exhibit 10. On a printout of "Application Solicitation Info" for Debtor, annual income is indicated as "15". This number was not explained to the Court. See, e.g., Field, slip op. at 13 (stating Universal's business records included no information on the debtor's actual income, only a demographic figure that is irrelevant to the debtor's particular situation).

In 1995 when Universal Bank preapproved a credit card account for Debtor with a \$3,000 credit limit, Debtor was earning gross income of \$5,000 annually. The only basis Universal Bank had for granting Debtor this line of credit was her FICO score, which merely reflects her past handling of credit card accounts. The Bank did not rely on any representation by Debtor of her creditworthiness. Debtor's continuing use of her credit card and payments on her account do not establish justifiable reliance of the Bank on any misrepresentation of Debtor. Rather, the Bank continued to rely on Debtor's FICO

score with no investigation of Debtor's income, assets or total debt. The Bank has failed to meet the requirements of §523(a)(2)(A) to prove it justifiably relied on a misrepresentation by Debtor.

WHEREFORE, Plaintiff Universal Bank's complaint to determine debt nondischargeable under §523(a)(2)(A) is DENIED.

FURTHER, Universal Bank has failed to prove that Debtor intended to defraud or that it justifiably relied on misrepresentations under §523(a)(2)(A).

FURTHER, judgment is entered accordingly.

SO ORDERED this 15th day of December, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge

1. The complaining creditors in the Field, Akins, Nguyen, Mercer and Ellingsworth cases are either the same or related to the Plaintiff herein, Universal Bank, N.A. In Mercer, the court set out detailed testimony of Ronald Lewis, "Bankruptcy Specialist" for the plaintiff, who is also Universal's sole witness in this case. 220 B.R. at 318.