

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 12-13158)
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SANDRA L. WALKER)
)
Debtor)
)
)
WELLS FARGO BANK, N.A.)
)
Plaintiff)
)
vs.) PROC. NO. 12-1228
)
SANDRA L. WALKER)
)
Defendant)

DECISION ON PLAINTIFF’S MOTION FOR DEFAULT JUDGMENT

At Fort Wayne, Indiana, on November 7, 2013.

This adversary proceeding seeks a declaration that debtor’s obligation to the plaintiff is non-dischargeable due to some type of fraud, misrepresentation or false pretenses. See, 11 U.S.C. § 523(a)(2). The defendant failed to answer the complaint and the matter is before the court following the second hearing on the plaintiff’s motion for default judgment. Plaintiff failed to present evidence supporting its claim when the motion was first heard. See, Fed. R. Civ. P. Rule 55(b)(2)(C) (court may hold a hearing before entering a default judgment to “establish the truth of any allegation by evidence.”); Notice of Hearing dated April 25, 2013 (“court will hold a hearing . . . to receive evidence and arguments concerning plaintiff’s motion . . .”). As a result, the motion was denied and plaintiff was ordered to show cause why the case should not be dismissed. See, Order Denying Motion dated June 7, 2013. Plaintiff filed a sufficient response to the order to show

cause and so the court gave it the opportunity to request a second hearing at which it could present the needed evidence supporting the relief sought. See, Decision and Order dated June 26, 2013. It did so. See, Notice of Hearing dated July 8, 2013. The matter was taken under advisement following that hearing.

The plaintiff's complaint seeks a determination that the debt owed to it is non-dischargeable pursuant to § 523(a)(2)(A) as the result of "false pretenses, a false representation, or actual fraud." Exceptions to discharge are narrowly construed in favor of the debtor, Matter of Scarlata, 979 F.2d 521, 524 (7th Cir. 1992), and the creditor bears the burden of proving that its debt falls within a particular exception. Grogan v. Garner, 498 U.S. 279, 291 (1991).

The debtor's obligation to the plaintiff arises out of a credit card agreement. Plaintiff's thesis is that by using the credit card and obtaining a cash advance, the debtor represented, if only by implication, that she had the intent and/or the ability to repay the debt. When she did not, and subsequently filed bankruptcy, those representations were proved to be false. As a result, the plaintiff has been defrauded, and the debt should be excepted from discharge. The court is skeptical. See e.g., In re Quinn, 492 B.R. 341 (Bankr. N.D. Ga. 2013); In re Zaldana, 2013 WL 2369754 (Bankr. E.D. Cal. 2013); In re Fuentes, 474 B.R. 497 (Bankr. S.D. Tex. 2012); In re Karagianis, 2009 WL 4738188 (Bankr. D. N.H. 2009); In re Alam, 314 B.R. 834 (Bankr. N.D. Ga. 2004). See also, In re Grause, 245 B.R. 95 (8th Cir. BAP 2000). Admittedly the failure to pay constitutes a breach, but the mere breach of a promise to pay does not, by itself, constitute a false representation, false pretenses or actual fraud. Quinn, 492 B.R. at 345; Alam, 314 B.R. at 837. Furthermore, the argument seems to prove too much: it would make the very act of default and filing bankruptcy prima facie proof of a fraud that would potentially render almost any debt non-dischargeable. An

argument that leads to such an absurd result has little to recommend it. Alam, 314 B.R. at 837-38. On a more individualized level, although the complaint alleges that the debtor misrepresented her intent to pay, other facts it contains lead to a contrary conclusion.¹ For example: there are conflicting allegations as to whether the credit limit was exceeded, compare, ¶ 19(f) with ¶ 37; almost all of the charges in question were the result of some type of automatic assessment against the account, such as late fees, interest, or overdraft protection fees, and not the debtor's conscious use of the card; the only charges that seem to stem from the debtor's affirmative use of the card occurred months before bankruptcy; and after using the card the debtor actually made some payments on the debt. Unless the court is required to believe that black is white simply because a defendant fails to respond to such an allegation, requiring proof of the assertion is in order. See, Fed. R. Civ. P. Rule 55(b)(2)(C) (court may hold a hearing before entering a default judgment to "establish the truth of any allegation by evidence."). See also, In re Baltran, 182 B.R. 820, 823-24 (9th Cir. BAP, 1995); Alam, 314 B.R. at 841-42.

To the extent the plaintiff claims that the debtor's use of the account constitutes some type of representation that she had the ability to pay the debt § 523(a)(2) forecloses the argument. The ability to pay would be a representation concerning the debtor's financial condition and before such a representation will provide a basis for excepting a debt from discharge it must be in writing. See, In re Kukuk 225 B.R. 778, 785 (10th Cir. BAP 1998); Alam, 314 B.R. at 834; AT&T Universal Card Services Corp. v. Searle, 223 B.R. 384, 390 (D. Mass. 1998) (quoting In re Anastas, 94 F.3d 1280, 1285-86 (9th Cir. 1996); In re Kountry Korner Store, 221 B.R. 265, 270-72 (Bankr. N.D. Okla.

¹Many of the complaint's paragraphs are not germane factual allegations at all, but simply quotes from various decisions. See e.g., ¶¶ 19, 31, 32, 33.

1998). See also, In re Joelson, 307 B.R. 689, 692-93 (10th Cir. BAP 2004) (statement not in writing regarding financial condition does not support claim of non-dischargeability). Here, there is no such written representation and so arguments based upon the debtor's financial condition, assets, or ability to pay must be disregarded.

The other aspect of the plaintiff's claim has a slightly firmer foundation. Although the reported decisions may debate whether the use of a credit card constitutes an implied representation that the borrower intends to repay the debt, all agree that if the debtor had no intent to repay when the obligation was incurred, that constitutes a fraud that will render the debt non-dischargeable. See e.g., Kukuk, 225 B.R. at 786; Searle, 223 B.R. at 389-90; Alam, 314 B.R. at 841; In re Bungert, 315 B.R. 735 (Bankr. E.D. Wis. 2004); In re Olwan, 312 B.R. 476 (Bankr. E.D. N.Y. 2004); Kountry Korner Store, 221 B.R. at 273; In re Briese, 196 B.R. 440, 450-51 (Bankr. E.D. Wis. 1996). This is a proposition that is neither surprising nor unique to credit cards, see, Briese, 196 B.R. at 449-50; and it is one the court wholeheartedly accepts. Nonetheless, we must remember that it is the debtor's subjective intent that is the focus of the court's inquiry; that intent is to be determined as of the time charge was made, Kukuk, 225 B.R. at 785, Briese, 196 B.R. at 451; and the plaintiff bears the burden of producing the facts needed to make that demonstration.

It is often difficult for a creditor to prove a debtor's subjective intent. Indeed, partly in response to those difficulties, § 523(a)(2) has been amended three times since 1978 to make some credit card charges and cash advances incurred shortly before the petition presumptively non-dischargeable. See, The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 103-394, § 306, 108 Stat. 4106 (1994); Bankruptcy Reform Act of 1994, Pub. L. 103-394 (Oct. 22, 1994); Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat.

23 § 310 (Apr. 20, 2005). The courts, too, have not been unsympathetic and have developed criteria or factors that may be examined to help determine the debtor's subjective intention. The ones most commonly used are those mentioned in In re Dougherty, 84 B.R. 653 (9th Cir. BAP 1988).² They are:

1. The length of time between the charges made and the filing of bankruptcy;
2. Whether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made;
3. The number of charges made;
4. The amount of the charges;
5. The financial condition of the debtor at the time the charges are made;
6. Whether the charges were above the credit limit of the account;
7. Whether the debtor made multiple charges on the same day;
8. Whether or not the debtor was employed;
9. The debtor's prospects for employment;
10. Financial sophistication of the debtor;
11. Whether there was a sudden change in the debtor's buying habits; and

²Although Dougherty itself was decided in 1988, the 12 factors it mentioned were taken from In re Faulk, 69 B.R. 743, 757 (Bankr. N.D. Ind. 1986) (Lindquist, J.), which got them from Matter of Carpenter, 53 B.R. 724, 730 (Bankr. N.D. Ga. 1985), a case that began in 1983, which got them from counsel's trial brief. Id. at 730. Trying to trace the lineage back, it seems some of these factors were in use as early as the mid-70's. See, Matter of Stewart, 7 B.R. 551 (Bankr. M.D. Ga. 1980) (citing In re Krantz, CCH, ¶ 65,924 (E.D. Wis. 1976); In re Alexander, CCH, ¶ 64,385 (D.C. Okla. 1972); In re Reinhart, 1 Bank. Ct. Dec. 666 (E.D. Va. 1975)). Either lineage predates the 1984 amendments to the Bankruptcy Code which first introduced the presumption of fraud created by § 523(a)(2)(C), to say nothing of the dramatic changes in the nature and use of credit cards that has occurred since they were created. In light of that evolution, it may be appropriate to reexamine those factors, instead of rotely repeating them, to see if they continue to be worthwhile considerations. Nonetheless, this is not the time to do so.

12. Whether the purchase were made for luxuries or necessities. Dougherty, 84 B.R. at 657.

It is important to remember that these factors are merely guides, which may or may not apply to any given case; they are not an exclusive list of what might be considered; their use is not to be an exercise in tallying up points for one side or the other; and no particular factor is determinative. See, In re Grause, 245 B.R. 95, 102 (9th Cir BAP 2000); Briese, 196 B.R. at 452 (“insight . . . is often lost in rote application of listed factors”). When they are applied to this case, the court finds it impossible to conclude that debtor lacked the intent to repay.³

Only a single charge is at issue in this case. That is a cash advance for \$1,500 the debtor obtained on May 1, 2012.⁴ At that time the account was in good standing and after receiving it, the debtor made a payment of \$116 on May 3, keeping it that way. Making a payment after charges have been incurred hardly supports the proposition that debtor had no intent to pay when the charges were made. Zaldana, 2013 WL 2369754 *8. It was not until the debtor failed to make the minimum payment of \$265 that was due over a month later, on June 20, that she defaulted.

The debtor did not consult a bankruptcy attorney until June 7, did not fully pay counsel until July 10, did not complete the required credit counseling until July 17, and did not file bankruptcy

³Although specifically advised that the purpose of the hearing was to receive evidence concerning the motion and plaintiff’s claims, see, Decision and Order, dated June 26, 2013; Notice of Hearing, dated July 8, 2013, the plaintiff did not produce any witnesses at the hearing. Instead, via rule 902(11) of the Federal Rules of Evidence, it offered into evidence copies of monthly account statements it mailed to the debtor and asked the court to take judicial notice of information in the debtor’s various bankruptcy filings. Given the lack of additional information or explanation, the court feels it has been given very little to work with where the debtor’s intent is concerned.

⁴Although the plaintiff’s complaint and motion for default judgment sought a declaration that \$4,819.04 was non-dischargeable, at the hearing on the motion it reduced that request to \$1,500 – the amount of the cash advance the debtor received on May 1, 2012.

until September 27. This suggests that the debtor did not intend to file bankruptcy at the time of the May 1 cash advance and that it was not until after that date that she began to contemplate the possibility.

There seems to be nothing unusual about the debtor's use of the account or the charge in question: a single cash advance, in a comparatively small amount, taken at a time when the account was in good standing, which did not exceed the debtor's available credit.

While the debtor's bankruptcy filings provide a good picture of her financial condition at the time of the petition, we do not have any specific information concerning her situation on May 1 when she took the cash advance. Furthermore, the court is reluctant to conclude that insolvency indicates a lack of intent to pay and therefore points to fraud. Alam, 314 B.R. 840. That seems to be little more than an end run around the requirement that representations concerning financial condition must be in writing, as well as the proposition that the use of a card represents nothing concerning the debtor's financial condition or ability to pay. It may say something about the reasonableness of the debtor's belief or intent to pay, but we should be wary of concluding, with the benefit of 20/20 hindsight, that such a belief might have been unreasonable and therefore non-existent. Kukuk, 225 B.R. at 787; Olwan, 312 B.R. at 489-90; Searle, 223 B.R. at 391; Alam, 314 B.R. at 841; Briese, 196 B.R. at 452. This is especially so since it is debtor's subjective intent that is determinative and solvency is an objective determination. Much the same can be said about the debtor's income and expenses. Based upon her bankruptcy schedules and statement of affairs, she was employed by CVS, both on the date of the petition and on the date she took the cash advance. While her expenses may have exceeded her income on the date of the petition, we do not know how things stood on May 1. Even then, the disparity is not so great that the court is willing to conclude

it evidences a lack of intent to pay.

We know nothing about the financial sophistication of the debtor.

Plaintiff has now had two opportunities to present evidence to support its claim that the debtor's cash advance of May 1 was procured through fraud, and therefore non-dischargeable, and has been unable to do so. Its motion for default judgment will be DENIED and this adversary proceeding will be dismissed. Accord, Beltran, 182 B.R. 820; Breise, 196 B.R. 440; Zaldana, 2013 WL 2369574. An order doing so will be entered.

/s/ Robert E. Grant
Chief Judge, United States Bankruptcy Court