UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

STEPHEN JOSEPH GROSS JR. and
BONNIE SUE GROSS,

Debtors.
_____/

Case No. ST 00-08066
Chapter 7

UNIVERSAL BANK, N.A.,

Plaintiff,

v.

STEPHEN JOSEPH GROSS JR. and
BONNIE SUE GROSS,

Defendants.
_____/

Adversary Proceeding
No. 01-88015

NOT FOR PUBLICATION

The principal issue before this Court is whether the Debtors defrauded Universal Bank by never intending to repay cash advances and credit card charges incurred approximately three months prior to bankruptcy. Universal Bank filed a Complaint to Determine Nondischargeability pursuant to 11 U.S.C. §§523(a)(2)(A) and (6).

The nondischargeability claims presented in this adversary proceeding arise in a case referred to

this Court by the Standing Order of Reference entered by the United States District Court for the Western District of Michigan on July 24, 1984. This Court has jurisdiction over this case pursuant to 28 U.S.C. §1334(b). As this is a core proceeding under 28 U.S.C. §157(b)(2)(I), the Bankruptcy Court is authorized to enter a final judgment subject to the appeal rights afforded by 28 U.S.C. §158 and Fed. R. Bank. P. 8001 et. seq.

The following constitutes the Court's findings of fact and conclusions of law in accordance with Fed. R. Bank. P. 7052. In reaching its determinations, we have considered the demeanor and credibility of all witnesses who testified, the exhibits properly admitted into evidence, and the parties' trial briefs and closing arguments.[1]

Background

In 1998, the Debtors had an income of $34,508.00 before taxes. Mrs. Gross worked as a manager of a medical office making approximately $11.00 per hour and Mr. Gross worked for Independent Floor Covering as a salesman.

By 1999, Mrs. Gross had ceased working due to the impending birth of their youngest child. This, combined with the failure of Independent Floor Covering to pay some of the commission due Mr. Gross, decreased their annual income to $21,981.00. Nevertheless, the Grosses managed to make each and every monthly payment due on their AT&T Universal credit card for that year.

In or around September 1999, Mr. Gross left Independent Floor Covering and took another job

[1]At this time the Court would like to compliment both attorneys on their cogent and comprehensive trial skills. Both did an excellent job of presenting their case to the Court.

at the Home Depot in Port Huron, Michigan where he earned $27,713.00 annually. Mrs. Gross remained unemployed.

In April of 2000, Mr. Gross was offered and accepted a job in the Cadillac, Michigan Home Depot store. The Grosses eventually decided to move from Port Huron to Cadillac in order to be closer to Mr. Gross' job. At this time, the Grosses had approximately $90,000.00 in credit card debt including charges and cash advances. They also had an offer on the table of $119,900.00 for the purchase of their home. The Grosses planned to net approximately $40,000.00 from this sale, liquidate Mrs. Gross' 401K, clearing about $20,000.00, and purchase a house in Cadillac financed at 125% of its value. They also intended to transfer their current credit card balances to a credit card company offering an introductory interest rate of 3.9%. Between the equity in the home, the 401K distribution, the balance transfer and the financing arrangement of a new house, the Grosses believed they would be able to pay off their credit card debt in full.

In furtherance of this plan, on or before April 30, 2000, Mrs. Gross liquidated her 401K netting approximately $16,111.00. She promptly had a cashier's check issued to AT&T Universal covering the outstanding balance of $10,500.27. She also requested in writing that the account be closed. The remaining $6000.00 went to moving expenses and other bills. Unfortunately, after the balance on the AT&T Universal card was paid, the sale of the house fell through.

As good luck would have it, there was another offer waiting on the house but for slightly less money. Just as good luck can quickly turn to bad, this deal also failed to materialize due to a dispute regarding an alley next to the house. As ill luck seldom comes alone, the Grosses ultimately had to file suit against their title insurance company. Even though they prevailed, they were assessed $5,000.00 in

attorney's fees, which their attorney generously agreed to pay.[2]

Once the lawsuit was decided, the Grosses listed their house with a realtor for $114,500.00. By this time, the Grosses had moved from Port Huron to Cadillac thereby incurring monthly rent in addition to the mortgage payment on their house. In June 2000, they accepted a purchase offer of $110,000.00. Unfortunately, this offer also fell through due to an adverse claim involving a six foot strip of real property.

Due to the difficulties in selling their house, the Gross' financial situation became more dire with each passing day. They were unable to cover day-to-day living expenses without the use of credit cards and cash advances. Consequently, the AT&T Universal credit card balance just paid off in May of 2000 was now up to $11,345.54 by September. When they consulted a bankruptcy attorney, he advised them to stop paying the mortgage on the home and to stop using the credit card. They ultimately filed bankruptcy on October 10, 2000. In November 2000, foreclosure proceedings were commenced. The house was finally sold for $100,500.00 and after $35,000.00 in closing costs, the Grosses netted about $6,300.00.

The Bank argues that the Grosses engaged in credit card kiting by using cash advances from one card to pay another, fully aware of their inability to pay. They incurred all of the charges three months prior to filing bankruptcy with $4,535.72 charged within 60 days of filing. Even though the Grosses attempted to sell their home to pay the charges, they had known since 1997 that any sale would be difficult due to right-of-way issues that would also decrease the value of the home. Moreover, during the pendency of four sales of their home, the Grosses continued to run up credit card charges.

The Bank further contends that the circumstances surrounding the Gross' use of the AT&T

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[2]The parties were unclear as to why the Grosses were assessed attorney's fees but guessed it was due to the "offer of judgment rule."

Universal credit card mirror several factors in the nonexclusive list used to determine the debtor's intent to repay as cited in Rembert v. AT&T Universal Card Services, Inc. (In re Rembert), 141 F.3d 277 (6th Cir. 1998).[3] Consequently, under the totality of the circumstances, the Grosses incurred debt which they did not intend to repay.

The Debtors argue that they always intended to pay the credit card debt, this intent being evidenced by the liquidation of Mrs. Gross' 401K and subsequent payment of the bill in total. They also contend that they could have repaid the debt with the proceeds garnered from the sale of their home, minimum payments and 3.9% financing offers. If necessary, Mrs. Gross could have returned to work. They claim that the debt is dischargeable.

Discussion

11 U.S.C. §523(a)(2)(A) provides an exception to discharge for any debt:

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by–
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or insider's financial condition.

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[3]Some of the circumstances to which the Court can look to determine intent include: 1) the length of time between the charges and the filing of the bankruptcy; 2) whether 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 were 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) the debtor's financial sophistication; 11) whether there was a sudden change in the debtor's buying habits; and 12) whether the purchases were made for luxuries or necessities

In order for a debt to be determined nondischargeable under 11 U.S.C. §523(a)(2)(A) for fraud, the creditor must show by a preponderance of the evidence: 1) that the debtor made a representation; 2) that he made the representation at a time when he knew the representation was false; 3) that the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor; 4) that the creditor relied on such representation; and 5) that the creditor sustained a loss as the proximate result of the representation having been made. Longo v. McLare (In re McLare), 3 F.3d 958 (6th Cir 1993); Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654 (1991). Exceptions to discharge are to be strictly construed against the creditor. Manufacturer's Hanover Trust v. Ward (In re Ward), 857 F.2d 1082 (6th Cir. 1988).

The focus in the present case is on the second and third elements: material misrepresentation and intent to defraud. Whether a debtor possesses an intent to defraud a creditor within the scope of §523(a)(2)(A) is measured by a subjective standard. Field v. Mans, 516 U.S. 59, 116 S.Ct. 437 (1995).

The use of a credit card represents either an actual or implied intent to repay the debt incurred. Rembert v. AT&T Universal Card Services, Inc. (In re Rembert), 141 F.3d 277 (6th Cir. 1998). However, to measure a debtor's intention to repay by his ability to do so, without more, would be contrary to one of the main reasons consumers use credit cards: to wit, they often lack the ability to pay in full at the time they desire credit. Consequently, the focus of inquiry must be solely on whether the debtor maliciously and in bad faith incurred credit card debt with the intention of petitioning for bankruptcy and avoiding payment.

Because direct proof of intent is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred. Thus, the nonexclusive list of twelve factors previously mentioned. But along with the factors enumerated in Rembert, the Sixth Circuit also

stated:

> [W]e believe that "factor-counting" is inappropriate when applying a subjective standard . . What courts need to do is determine whether all the evidence leads to the conclusion that it is more probable than not that the debtor had the requisite fraudulent intent. This determination will require a review of the circumstances of the case at hand, but not a comparison with circumstances (a/k/a factors) of other cases.

Rembert, 141 F.3d at 282 (Quoting Chase Manhattan Bank v. Murphy (In re Murphy), 190 B.R. 327 (Bankr. N.D. Ill 1995). Viewing the totality of the circumstances, the Gross' conduct was entirely consistent with a subjective intent to repay.

Although Universal asserts that the Grosses were financially sophisticated, we find otherwise. Mrs. Gross liquidated her 401K account using that money to pay off the entire balance owed on their AT&T Universal credit card. This resulted in Mrs. Gross losing her retirement exemption and paying off an otherwise dischargeable credit card debt.

Mr. Gross also testified that part of their "plan" to pay all credit card debt was to transfer their balances to a card with an initial 3.9% interest rate. The Bank pointed to this as proof of the Debtor's financial savvy. However, in order for the Debtors to take full advantage of this offer, they must first have been approved. This was certainly not guaranteed. The Debtors must have also been able to pay the balance in full before the initial interest rate offering expired. Mr. Gross testified that he had taken advantage of these offers before, but could never pay the balance before the interest rates went up.

Universal also argues that the evidence indicated a sudden change in the Debtors' buying habits. It asserts that after the Grosses made the large payment in May of 2000, they very shortly were back up to their credit limit. However, the Debtors' spending activity following the pay-down was consistent with their prior spending habits. As of May 2000, the Grosses had a credit limit of $11,000.00 on their AT&T

Universal credit card of which they had used all but approximately $500.00. Because in the months prior to the pay-down they were very nearly at that limit, it was impossible for them to continue to use the card in the same manner until after the balance was reduced. Once they paid the outstanding balance they had $11,000 of available credit, which they used.

We agree that Universal proved the existence of some of the Rembert factors. The Debtors did have a large number of charges, sometimes more than one per day per store, in a short period of time. Almost all of these charges were relatively small in amount and incurred at stores such as Kmart, Walmart, Meijer, grocery stores and gas stations. However, this is explained by their inability to sell their house, their need to move closer to Mr. Gross' job, the need to find a rental house while waiting for their house to sell and basic living necessities. None of the charges appear to be for luxury items with the exception of a short vacation to Mears, Michigan where they stayed at a hotel, went for a dune buggy ride and bought their children souvenir T-shirts.

Even so, the factors enumerated in Rembert are nonexclusive; none is dispositive, nor must a debtor's conduct satisfy a certain number in order to show fraudulent intent. American Express Travel Related Services v. Hashemi (In re Hashemi), 104 F.3d 1122 (9th Cir. 1997). With this principle in mind, we conclude that the overall picture demonstrates that the Grosses did not defraud Universal. They had been in a precarious financial condition for years, always making their monthly credit card payments but obviously living above their means. Under these circumstances it took relatively little to tip them over the edge of the abyss. Even after almost reaching their credit limit after the May 2000 payoff, the Grosses continued to make their monthly credit card payments until September when they were advised otherwise by their attorney. At that time they ceased using their

credit card completely. We find these facts to indicate that the Grosses subjectively intended to repay their debts at the time they were incurred.

The Bank also argued that the debt should be declared nondischargeable under 11 U.S.C.§523(a)(6). This section provides that a debt is nondischargeable if there is "willful and malicious injury by the debtor to another entity or to the property of another entity." In Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974 (1998), the Supreme Court stated that in order for a debt to be found nondischargeable under this section the debtor must have intended the consequences of the act, not simply the act itself. In light of the reasoning and conclusion that the Debtors intended to repay Universal Bank, we also find for the Debtors' on this count.

Dated: August 24, 2001

Honorable Jo Ann C. Stevenson
United States Bankruptcy Judge

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ORDER

At a session of said Court, held in and for said District, at the United States Bankruptcy Court, Federal Building, Grand Rapids, Michigan this 24 day of August, 2001.

PRESENT: HONORABLE JO ANN C. STEVENSON
United States Bankruptcy Judge

NOW, THEREFORE, IT IS HEREBY ORDERED that the debt owed by the Grosses to Universal Bank is DISCHARGED.

It is further ordered that a copy of this Opinion and Order shall be served by first-class United State mail, postage prepaid upon Universal Bank, Lisa E. Gocha, Esq., Stephen J. Gross, Bonnie Sue Gross and Gerald G. Green, Esq.

Dated: August 24, 2001

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Honorable Jo Ann C. Stevenson
United States Bankruptcy Judge

Served as ordered:

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