UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In Re	:	**Case No. 98-03996-CH**
DAVID LEE BOHNSTENGEL, and KATHLEEN CORA BOHNSTENGEL,	:	**Chapter 7**
Debtors.	:	
FCC NATIONAL BANK,	:	**Adv. No. 98-98238**
Plaintiff,	:	
v.	:	
DAVID LEE BOHNSTENGEL, and KATHLEEN CORA BOHNSTENGEL,	:	
Defendants.	:	

ORDER—COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On November 2, 1999, trial was held on the Plaintiff's Complaint to Determine Dischargeability of Debt. Plaintiff, FCC National Bank d/b/a/ First Card, was represented by attorney Thomas H. Burke; Defendants, David Lee and Kathleen Cora Bohnstengel, were represented by attorney David A. Morse. At the conclusion of the trial, the court took the matter under advisement upon a briefing schedule. Post-trial briefs have been filed, and the court now considers the matter fully submitted.

The court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334 and order of the United States District Court for the Southern District of Iowa. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I). The court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. The plaintiff, FCC National Bank (FCC or Plaintiff), is a creditor of the debtors as the result of First Card Visa credit card account number 4678-310-577-357.

2. The defendants are Kathleen Cora Bohnstengel and her husband, David Lee Bohnstengel, Jr. (Defendants or Debtors). Defendants filed a joint Chapter 7 bankruptcy petition on September 10, 1998.

3. Defendants owned and operated Café-A-Roma (café). The café was a kiosk in the Des Moines skywalk. Defendants sold coffee and doughnuts from the café. Kathleen Bohnstengel worked at the café full-time. David Bohnstengel helped at the café in the morning before he went to his job at Aladdin and in the evening after he got off work. He also "kept the books" for the café.

4. Defendants purchased the café from Harry and Wendy Breaux on October 6, 1997. At that time, Kathleen Bohnstengel quit her job at the airport to operate the café. The purchase was financed by West Bank and guaranteed by the Small Business Administration. The operation was unsuccessful and Defendants never made a profit from the café. The business deteriorated during the summer of 1998 and ultimately closed in September of 1999. The failing of the business precipitated Defendants filing for Chapter 7 relief.

5. In June of 1998, Kathleen Bohnstengel received an unsolicited, "exclusive invitation" for a pre-approved Platinum Visa credit card from FCC. The invitation stated that she was "pre-qualified" for a credit line of "up to $25,000." The invitation encouraged her to transfer other credit card balances to this Visa. The "initial balance

transfers" would have an APR of 4.9% until March 1, 1999, and no transaction fee would be charged on the transfers.

6. On June 14, 1998, Kathleen Bohnstengel signed the acceptance certificate and indicated annual household income from all sources was $42,211. She also stated that her occupation was self-employed. A joint account was requested, and David Bohnstengel signed as co-obligor. Kathleen Bohnstengel completed the initial transfer form. She requested FCC transfer $5,800 from her G.E. Card Services MasterCard account and $1,300 from her First Bankcard Visa account to the FCC account.

7. The annual household income figure of $42,211 was based on David Bohnstengel's previous year, 1997, income of $34,000 from employment at Aladdin, and Kathleen Bohnstengel's 1997 income from employment at the Des Moines airport. Kathleen Bohnstengel's 1997 income from the airport job was not scheduled on the statement of financial affairs.

8. On June 22, 1998, FCC received the acceptance certificate at their Delaware offices.

9. FCC opened the Bohnstengel account prior to July 13, 1998. The credit limit was set at $7,500.

10. On July 13, 1998, FCC charged a cash advance of $7,100 to the Bohnstengel account.

11. On July 14, 1998, FCC paid $5,800 to GE Card Service and $1,300 to First Bankcard.

12. Defendants received no cash from FCC and did not use the FCC Visa for any subsequent purchases or transactions.

DISCUSSION

Plaintiff has requested that its claim be determined nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A), and the parties have briefed the matter accordingly. At hearing, Plaintiff's counsel elicited testimony concerning the veracity of Defendants' statement of annual household income written on the acceptance certificate. Counsel argued that Plaintiff relied on this statement in determining to extend credit. Such an argument should be brought pursuant to 11 U.S.C. § 523(a)(2)(B). Because the issue was not raised or briefed, and the heightened level of reasonable reliance required by § 523(a)(2)(B)(iii) was not addressed, the court will confine its analysis to § 523(a)(2)(A).

The Bankruptcy Code provides that a debt is not dischargeable to the extent that it was obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). The plaintiff has the burden of proving the debtor's deceit by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286-87 (1991). The Eighth Circuit has adopted a five-part test to determine whether a debt will be excepted from discharge under § 523(a)(2)(A). The court asks whether: (1) the debtor made false representations; (2) the debtor knew these representations were false at the time they were made; (3) the debtor made these representations with the intention and purpose of

deceiving the creditor; (4) the creditor justifiably relied on the representations; and, (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987) as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that § 523(a)(2)(A) requires "justifiable, but not reasonable, reliance").[1]

"The first, second, and third elements can be considered together by asking whether the debtor made false representations knowingly and with the intent to deceive the creditor." AT&T Universal Card Services v. Broerman (In re Broerman), No. 97-2569-CH, Adv. No. 97-97203 at 5 (Bankr. S.D. Iowa Jan. 19, 1999) (Judge Hill decision book # 313). The use of a credit card serves as an implied representation that the cardholder has the intention and ability to repay the debt. Id.; see also, In re Stewart, 91 B.R. 489, 494 (Bankr. S.D. Iowa 1989). "*However*, insolvency alone does not establish intent to deceive." Id.; see also, In the Matter of Cron, 241 B.R. 1, 5 n. 7 (Bankr. S.D. Iowa 1999). In order to prevail, FCC must prove that the debtors had neither the intention nor the ability to pay the charges at the time that they were made.

Intent to deceive may be proven by circumstantial evidence. In re Van Horne, 823 F.2d at 1287. The following nonexclusive list of factors is considered by the court:

1) the length of time between making the charges and filing bankruptcy;
2) whether an attorney had been consulted concerning filing of bankruptcy before the charges were made;
3) the number of charges;

[1] Both parties cite In re Ophaug, 827 F.2d 340 (8th Cir. 1987) for the proposition that the creditor's reliance need not be reasonable. Both Ophaug and Van Horne contain the five part test to determine whether a debt is excepted from discharge, the difference being the required reliance. As Ophaug was the latter decided case, it might well control, however, the United States Supreme Court in Fields determined that the proper standard is "justifiable reliance." Additionally, Van Horne held that the plaintiff had the burden of proving the debtor's deceit by clear and convincing evidence. In Grogan, the United States Supreme Court held the proper standard to be by the preponderance of the evidence. The balance of Van Horne remains good law.

4) the amount of charges;
5) whether multiple charges were made on the same day;
6) whether the charges were above the credit limit on the account;
7) whether the purchases were for luxuries or necessities;
8) a sharp change in the buying habits of the debtor;
9) the debtor's financial sophistication;
10) the financial condition of the debtor when the charges were made;
11) the debtor's employment circumstances; and
12) the debtor's prospects for employment.

In re Stewart, 91 B.R. at 495. In considering these and additional factors in their totality, the court finds that Kathleen Bohnstengel did not intend to deceive FCC when she transferred her other credit card balances to the FCC Visa account.

First, the court finds Kathleen Bohnstengel to be a credible witness. It accepts her statement, at least subjectively, that she intended to pay the charges when she made them and that she intended to pay FCC when she made the balance transfers. The court also accepts that she transferred the account balances to the FCC Visa for the benefit provided by lower interest rates. The debtors did not receive any cash or make any additional purchases or transactions with the FCC Visa cards they acquired. Kathleen Bohnstengel refinanced an existing debt. See First Deposit National Bank v. Cameron (In re Cameron), 219 B. R. 531, 540-41 (Bankr. W. D. Mo. 1998); Thorp Credit, Inc. v. Smith (In re Smith), 54 B. R. 299, 301-02 (Bankr. S.D. Iowa 1985).

Second, although the court does not engage in factor counting, rather choosing to weigh all the factors in the totality, it nevertheless notes that the plaintiff identifies only three factors that weigh in its favor. Plaintiff argues that less than sixty (60) days passed between the transfer and filing of bankruptcy; the debtors were "hopelessly insolvent " when the transfer took place; and Mrs. Bohnstengel's employment was precarious

because the café was in dire financial straits at the time the transfer was made. (Plain. Brief at 4).

While it may be true that FCC processed the transfer and sent the checks to G.E. Card Service and First Bankcard on July 14, 1998, approximately 56 days before the bankruptcy petition was filed, it is equally true that Kathleen Bohnstengel signed and sent the acceptance certificate a full month before that time. Plaintiff admits that it received the acceptance certificate on June 22, 1998. In order to determine Kathleen Bohnstengel's intent, the court must look at the time that she initiated the transfer process, not the time the transfer was finally completed.

Additionally, Defendants' summary of schedules indicates that as of the filing date, liabilities exceed assets by $9,728. David Bohnstengel testified that some of the liabilities were incurred by the café in the final month of its operation. There was no testimony that any of the assets were acquired during that time. Based on the evidence, the court is unwilling to find that Defendants were "hopelessly" insolvent in June of 1998.

Further, the following factors weigh in Defendants' favor. Defendants did not contact an attorney about filing bankruptcy before requesting the transfers. Only two balances were transferred and no other charges, cash advances, or other transactions were made. The amount of the transfers, $7,100.00, was solicited and pre-approved by FCC. Defendants were current on the credit card accounts that were transferred to FCC and were paying the vendors of the café at the time the acceptance certificate was sent. The amount of the transfers did not exceed the account credit limit. Kathleen Bohnstengel

was working at the time the charges were made and indicated that she was self-employed on the acceptance certificate. There is no evidence of a change in buying habits, luxury purchases, or loading up of debt.

The court finds that Defendants are not financially sophisticated. There is no evidence that either debtor has post secondary education. Kathleen Bohnstengel testified that she operated Café-A-Roma and her husband did the accounting for the business. There is no evidence that David Bohnstengel has any accounting training. His full time employment with Aladdin, a laundry service, is not in the accounting department.

Finally, the court finds that the failure of Café-A-Roma precipitated Defendants' filing for Chapter 7 protection. Kathleen Bohnstengel quit her job at the airport to operate the café. Debtors' hopes of a profitable business never materialized. Among other things, the debtors testified that they had trouble keeping employees. As a result, they were constantly training new employees and were unable to keep anyone long enough to become proficient. Understandably, customer service suffered and business dwindled. The café failed to make a profit. Defendants testified that they were not receiving any pay for their time at the café. In September, they came to the realization the business was failing, and they would be unable to continue operations.

For all the foregoing reasons, the court finds that the defendant, Kathleen Bohnstengel, did not intend to deceive FCC when she signed and sent the acceptance certificate and requested the balances be transferred from her G.E. Card Services MasterCard and First Bankcard Visa to the FCC First Card Account. As the 9th Circuit recognized:

> It is well known that credit card issuers compete for new users and a great deal of the marketing effort encourages customers to transfer credit card balances, usually at very low interest, to a new issuer. It is not at all unlikely for a person of average means to receive new credit cards unsolicited. Even where the invitation requires an application before issuance, the inducements may be too attractive to resist by people who should. Mr. Eashai, an unemployed holder of 26 credit cards, may not fit this profile; nevertheless, it would be wrong to conclude that a person who genuinely becomes overextended, perhaps because of the availability of too much free and easy credit, risks nondischargeability. In short, the credit card issuer is not entirely blameless in this equation.

Citibank v. Eashai (In re Eashai), 87 F.3d 1082, 1092 (9th Cir. 1996), see also Anastas v. American Savings Bank (In re Anastas), 94 F.3d 1280 (9th Cir. 1996); Star Bank, N.A. v. Stearns (In re Stearns), 241 B.R. 611 (D. Minn. 1999); AT&T Universal Card Services, Corp. v. Searle, 223 B.R. 384 (D. Mass. 1998); Hecht's v. Valdes (In re Valdes), 188 B.R. 533 (Bankr. D. Md. 1995); Citibank v. Davis (In re Davis), 176 B.R. 118 (Bankr. W.D.N.Y. 1994).

The court holds that Plaintiff did not carry its burden in proving that Defendants knowingly made false representations with the intent to deceive Plaintiff. Plaintiff fails to satisfy the first three elements of the test. In order for a debt to be excepted from discharge all the elements of fraud must be met. Beneficial of Missouri v. Shurbier (In re Shurbier), 134 B.R. 922, 926 (Bankr. W. D. Mo. 1991), citing Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 (8th Cir. 1987). Therefore, Defendants' debt to FCC is not excepted from discharge.

Even if the court found that Defendants made a false implied representation, it would be hard pressed to find that FCC justifiably relied on that representation. FCC sent Kathleen Bohnstengel an unsolicited invitation for a pre-approved credit card. She signed and mailed the acceptance certificate on June 14, 1998, indicating that she wished

to transfer two balances to the FCC account. Presumably, the representation occurred when a cash advance was charged to the account on July 13, 1998. Therefore, FCC relied on a representation that occurred after the credit was extended. See In re Cameron, 219 B. R. at 538.

Defendants pray, that in the event they prevail in this proceeding, they be awarded costs and reasonable attorney's fees pursuant to § 523(d). Section 523(d) states:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such 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.

"The purpose of § 523(d) is to discourage creditors from initiating meritless actions based on § 523(a)(2) in the hope of obtaining a settlement from an honest debtor anxious to save attorney's fees." H.R. Rep. No. 595, 95th Cong., 1st Sess. 365 (1077); S. Rep. No. 989, 95th Cong., 2d Sess. 80 (1978); U.S. Code Cong. & Admin. News, pp. 5787, 5865, 5963, 6320; American Savings Bank v. Harvey (In re Harvey), 172 B.R. 314, 319 (B.A.P. 9th Cir. 1994), citing In re Itule, 114 B.R. 206, 213 (B.A.P. 9th Cir. 1990).

In order to receive an award under § 523(d), the debtors have the burden of proving that the creditor filed a dischargeability action pursuant to § 523(a)(2), that the debt sought to be excepted from discharge is a consumer debt, and that the debt was discharged. If the debtors make the required showing, the burden then shifts to the creditor to prove that its position was substantially justified and/or that there are special circumstances that would make an award of damages unjust. Household Bank, N. A. v. Sales (In re Sales), 228 B.R. 748, 751 (B.A.P. 10th Cir. 1999); In re Harvey, 172 B.R.

314, 317 (B.A.P. 9th Cir. 1994); AT & T Universal Card Services Corp. v. Williams (In re Williams), 224 B. R. 523, 529 (B.A.P. 2nd Cir. 1998); Mid Am. Credit Union v. Glazier (In re Glazier), 1991 WL 177698 *3 (D. Kan. 1991); FCC National Bank v. Friend (In re Friend), 156 B.R. 257, 262 (Bankr. W. D. Mo. 1993); American Express Travel Rel. Serv. Co. v. Baker (In re Baker), 206 B.R. 507, 509 (Bankr. N. D. Ill. 1997); Chase Manhattan Bank v. Talarico (In re Talarico), 234 B.R. 182, 184 (Bankr. E.D. Fla. 1999).

In formulating § 523(d), Congress modeled the standard after that of the Equal Access to Justice Act (EAJA), 28 U.S.C. § 2412(d)(1)(A). In re Williams, 224 B.R. at 528. In the context of the EAJA, the United States Supreme Court defined "substantially justified" as "justified to a degree that could satisfy a reasonable person." Pierce v. Underwood, 487 U.S. 552, 565 (1988). This definition "is not different from the 'reasonable basis in fact and law' formulation adopted by the Ninth Circuit and the vast majority of other Courts of Appeals that have addressed this issue." Id. "Substantially justified" is "more than merely undeserving of sanctions for frivolousness." Id.

Some courts apply a three-part test to determine reasonableness. The criteria used "are a reasonable basis in law for the theory it propounds; a reasonable basis in truth for the facts alleged; and a reasonable connection between the facts alleged and the legal theory advanced." In re Williams, 224 B.R. at 531. Others look at the totality of the circumstances and weigh such factors as whether the creditor attended the § 341 meeting of the creditors, conducted a Rule 2004 examination, or conducted an informal investigation. Id.

Further, the plaintiff must be substantially justified at all times throughout the proceedings. The court need not find that the plaintiff acted in bad faith, only that it '"proceeded past the point where it knew, or should have known, that it could not carry its burden of proof.'" In re Williams, 224 B.R. at 530, quoting In re Williams, 217 B.R. 387, 389 (Bankr. D. Conn. 1998), citing In re Harvey, 172 B.R. at 318-19; See also, In re Friend, 156 B.R. at 261, citing Beneficial of Mo. V. Shurbier (In re Shurbier), 134 B.R. 922, 928 (Bankr. W.D. Mo. 1991). Before commencing an adversary under § 523(a)(2), the plaintiff "'must ascertain that it has sufficient facts to prove its claims.'" Id., quoting Chevy Chase, F.S.B. v. Kullgren (In re Kullgren), 109 B.R. 949, 954 (Bankr. C.D. Cal. 1990).

Even if a plaintiff is not substantially justified in pursuing its § 523(a)(2) action, the court shall not award costs and attorney's fees to the defendant if special circumstances would make an award unjust. Special circumstances exist where the plaintiff has "advanced a novel legal theory ... or the debtor has unclean hands. AT&T Universal Card Services v. McIvor, 1997 WL 749425 * 3 (E.D. Pa. 1997) citing In re Woods, 69 B.R. 999, 1004 (Bankr. E.D. Pa. 1987).

Finally, the bankruptcy court is not required to conduct an evidentiary hearing on the issue of awarding attorney's fees and costs. In re Williams, 224 B.R. at 527 and n. 3. It may review the record to determine whether an award is appropriate. In fact, the United States Supreme Court warns against an additional lawsuit over the issue of attorney's fees. Id. at 527, n. 2. Defendants' answer provided Plaintiff with notice that they would pursue such an award.

For the following reasons, the court concludes that Plaintiff was not substantially justified in pursuing its nondischargeability action. Defendants have carried their burden under § 523(d).

First, the court finds that on December 8, 1998, Plaintiff filed a Complaint to Except Indebtedness from Discharge and to Avoid and Deny Discharge to Debtor/Defendant pursuant to 11 U.S.C. § 523(2)(A).

Second, the court finds that the debt sought to be discharged is a consumer debt. Plaintiff has not contended that the debt was for anything other than consumer goods. In fact, in opposition to Defendants' motion for summary judgment, Plaintiff argued that one "legitimate factual dispute" for the court to determine was whether the presumption in favor of nondischargeability pursuant to 11 U.S.C. § 523 (a)(2)(C) was applicable. (Plaintiff's Brief in Res. to Sum. J. at 3). The § 523(a)(2)(C) presumption is applicable when the debtor incurs consumer debts for luxury goods or services within sixty (60) days of filing for bankruptcy.

Third, the court found that Kathleen Bohnstengel did not commit fraud or misrepresentation when she transferred account balances from two credit cards to the FCC Visa account. Accordingly, the debt is discharged. Therefore, the burden of proof shifts to Plaintiff to prove that it was substantially justified in pursuing the action. The court holds that Plaintiff has not met this burden.

The court finds that Plaintiff did not conduct any preliminary investigation before filing its complaint. Plaintiff did not attend the first meeting of the creditors, nor did it request a Rule 2004 examination of Defendants. There is no evidence in the record that

Plaintiff contacted Defendants' attorney or conducted any informal inquiry into the matter. Rather, Plaintiff relied on its own records and information in the bankruptcy petition in determining to file the complaint.

The court is cognizant that Defendants' schedules were poorly prepared. Missing from the schedule of unsecured claims were dates when the claims were incurred. This omission was particularly troubling when the court questioned David Lee Bohnstengel about various claims.

More importantly, the statement of financial affairs contains misleading information concerning Defendants' 1997 income from Café-A-Roma. At trial Defendants admitted that the café had never made money, and the stated income from the café was gross receipts. At trial and in post-trial brief, Plaintiff argued that Defendants' income never approached the $42,211 indicated on the acceptance certificate. Kathleen Bohnstengel testified that they had neglected to include income from her employment at the airport on the statement of financial affairs. However, had Plaintiff addressed this as a preliminary matter, Defendants could have supplied verification of the stated income.

Finally, the court finds that Plaintiff's legal theory is fatally flawed. As earlier noted, Plaintiff relies on § 523(a)(2)(A) rather than § 523(a)(2)(B). Plaintiff argues that it relied on the amount of income stated on the acceptance certificate in deciding to extend credit to the defendants. This is clearly a written statement respecting Debtor's financial condition. 11 U.S.C. § 523(a)(2)(B). Plaintiff asks the court to combine the analysis of the two sections and discard those parts that are not to its liking. The court will not grant this request.

Section 523(a)(2)(B) requires that the creditor reasonably rely on the debtor's written representation. Section 523(a)(2)(A) is interpreted to require only that the creditor justifiably rely on the debtor's representation. Plaintiff's legal theory is that it relied on the written representation of income in extending credit, but it should only be held to a standard of actual reliance.

Actual reliance is mere reliance or reliance in fact. In re Orphaug, 827 F.2d at 343. Justifiable reliance is a higher standard. See Field, 516 U.S. at 66. The individual is '"required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation.'" Id. at 71. Reasonable reliance is a higher standard still. Id. at 76. The individual must exercise the care of a reasonably prudent person under the circumstances. Id. at 77, 80, 81. Because the alleged misrepresentation on which Plaintiff relied was a written statement concerning the debtors' financial condition, Plaintiff could not proceed on a legal theory of reliance in fact or even justifiable reliance. It was incumbent on Plaintiff to argue reasonable reliance.

For all the forgoing reasons, the court finds that Plaintiff was not substantially justified in pursuing its complaint. The court does not find any special circumstances that would make an award of costs and attorney's fees unjust. Therefore, Defendants' request for costs and attorney's fee must be granted.

ORDER

IT IS THEREFORE ORDERED, as follows:

(1) The debt of FCC Bank scheduled as First Card Visa Account Number 4678-310-577-357 in the name of Kathleen Bohnstengel is discharged;

(2) The defendant, Kathleen Cora Bohnstengel, shall have judgment against the plaintiff, FCC National Bank, dismissing the complaint; and,

(3) The defendants' request for costs and attorney's fee is GRANTED. Defendants shall give notice and file an application providing a detailed statement of the services rendered, time expended, expenses incurred, and the amounts requested, all within 15 days of the filing of this order. Any objections thereto shall be filed within 15 days after said application is filed with the court.

Dated this _____ day of July, 2000.

_____
RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT