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Melting the Plastic Theories: Advocating the Common Law of Fraud in Credit Card Non-dischargeability Actions under 11 U.S.C. § 523(a)(2)(A)

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NOTES

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I. INTRODUCTION

If credit card-holders purchase items they cannot afford, they may make minimum payments and avoid default. Most people carry debt on their credit cards,[1] and card-issuers who profit from interest

1. Approximately 35% of all card-holders pay their balances in full each month. Anne Marriott, *Charge It? Spontaneous Spending Can Be Buyers' Downfall*, The Washington Times C11 (Dec. 8, 1996). These "convenience users" are sometimes called "dead beats" or "freeloaders" by the credit industry. Michelle Singletary and Albert B. Crenshaw, *Flood of Credit Cards Leaves Sea of Bankruptcies*, Sacramento Bee F1 (Dec. 15, 1996).

on these balances encourage consumers to carry a balance.[2] When a debtor acquires too much debt and files for bankruptcy, the debtor may generally discharge all of his debts to gain a "fresh start."[3] This discharge of debts completely bars creditors from collecting the money owed to them, and the resulting losses have frustrated the credit card industry.[4]

To prevent debts from becoming uncollectible due to discharge, credit card-issuers frequently claim "fraud," alleging that a debtor used his credit card with the intention of filing for bankruptcy and discharging the debt.[5] Card-issuers bring such claims under section 523(a)(2)(A) (the "fraud exception") of the Bankruptcy Code[6] ("Bankruptcy Code" or "Code") which excepts from discharge those debts obtained by false pretenses, false representations, or actual fraud.[7] Upon proving that a debt is excepted from discharge, a card-issuer may collect that debt after the debtor obtains a discharge.

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2. In 1995, banks generated $35 billion in interest from debt carried on credit cards. Laurie Hays, *Credit Cards: Banks' Marketing Blitz Yields Rash of Defaults*, Wall St. J. B1 (Sept. 25, 1996). See Lawrence M. Ausubel, *Credit Card Defaults and Credit Card Profits*, 70th Annual Meeting of the Natl. Conference of Bankr. Judges, 8-5, 8-11 to 8-13 (Oct. 1996) (observing the overall profitability of the credit card industry compared to the banking system).

3. See generally 11 U.S.C. § 727 (1994). When enacting the Bankruptcy Code, Congress recognized that the discharge was "perhaps the most important element of the fresh start for a consumer." H.R. Rep. No. 595, 95th Cong., 1st Sess. 128 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6089. See also Elizabeth Gavit Filipow, Note, *Creditor Acquiescence as a Defense to an Exception to Discharge in Bankruptcy*, 58 Ind. L. J. 319, 329-331 (1982) (describing the "fresh start" policy in the Bankruptcy Act). For a general analysis of the discharge policy see Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 Ohio St. L. J. 1047 (1987).

4. See 11 U.S.C. § 524 (1994) (detailing effects of a discharge). In 1995, bank card losses from personal bankruptcies amounted to $4.7 billion, an increase of 45% from the previous year. These losses are expected to reach $9 billion in 1997. Ford Elsaesser, *Testimony Before House Committee on Banking and Financial Services on Consumer Debt, Delinquencies, and Personal Bankruptcy*, 1996 Am. Bankr. Inst. J. LEXIS 80, *3 (Oct.). Overall credit card losses due to bankruptcy exceeded $10.4 billion. Delinquency on Consumer Loans: Hearing of the House Banking and Financial Services Committee, 104th Cong., 2nd Sess. (Sept. 12, 1996) (available in LEXIS Federal News Service) (testimony of Rep. LaFalce). This figure presumably includes credit card losses suffered by non-banks such as AT&T and other private companies. See George Ritzer, *Expressing America* 34-41 (Pine Forge, 1995) (distinguishing between bank and non-bank credit cards). This note will not distinguish these entities but will refer to them generally as "card-issuers."

5. See *In re Sziel*, 206 B.R. 490, 490 (Bankr. N.D. Ill. 1997) ("This is a *routine* adversary proceeding alleging that the Debtor committed fraud in the use of a credit card" (emphasis added)); *In re Alvi*, 191 B.R. 724, 726 (Bankr. N.D. Ill. 1996) (noting routine filing of § 523(a)(2)(A) complaints by credit card-issuers); *In re Parkhurst*, 202 B.R. 816, 820 (Bankr. N.D.N.Y. 1996) (noting nationwide "influx" of § 523(a)(2)(A) complaints by credit card-issuers).

6. 11 U.S.C. §§ 101 et seq. (1994).

7. Id. § 523. Section 523 provides: "(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt . . . (2) for money, property, services, or an ex-

Historically, courts have struggled when determining whether a credit card-holder committed fraud under section 523(a)(2)(A). To overcome conceptual dilemmas, courts have created different theories for analyzing credit card debt under the fraud exception.[8] Some courts have recently discarded these credit card theories and have applied the common law of fraud to determine the dischargeability of credit card debt.[9] The common law of fraud primarily differs from the credit card theories in that the common law requires the credit card-issuer to prove a debtor's *subjective* intent to defraud and to show the creditor's own "justifiable reliance."[10]

Commentators have questioned the propriety of using the common law standard to evaluate modern credit card transactions.[11] Additionally, the common law standard conflicts with a recent proposal to Congress by the consumer credit industry advocating an expansion of section 523(a)(2)(A) to except from discharge any debt incurred without a *reasonable* expectation of repayment.[12] This proposal, precipitated by a record number of personal bankruptcies in 1996,[13] is merely a means for consumer creditors to recover losses from bankruptcy without changing their lending practices.[14] It results from

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tension, renewal, or refinancing of credit, to the extent obtained by—(A) false pretenses, a false representation, or actual fraud. . . ." Id.

8. See notes 33-44 and accompanying text.

9. See, for example, *In re Briese*, 196 B.R. 440, 449 (Bankr. W.D. Wis. 1996) (describing how the common law of fraud "neatly solves the struggle over conceptualizing credit card fraud"). See generally Lisa K. Gorman, *Rethinking Credit Card Fraud and* § 523(a)(2)(A), Norton Bankr. Law Advisor (Feb. 1997) (describing recent cases applying the common law of fraud).

10. *In re Briese*, 196 B.R. at 450-452. See Part II.D (discussing application of the common law of fraud to credit card cases).

11. See, for example, Martha Middleton and James J. Daly, *An Unreliable Proposition?*, 9 Credit Card Mgt. 106-108 (June 1996) (describing the credit industry's discord with the justifiable reliance standard of the common law fraud); *Is Reliance Becoming THE Issue in Credit Card Dischargeability Actions?*, 4 Consumer Bankr. News (Mar. 10, 1996) (discussing whether "courts are asking creditors to show unreasonable reliance").

12. *Economics: The Curtain Rises on the Latest Bankruptcy Drama*, Credit Card News (Dec. 15, 1996). The National Bankruptcy Review Commission, established in 1994, is investigating proposed changes to the Bankruptcy Code and is due to report to Congress, the Supreme Court, and President Clinton in October, 1997. Id. See also Elsaesser, 1996 Am. Bankr. Inst. J. LEXIS 80 at *9-10 (cited in note 4) (reciting proposals from consumer credit industry).

13. Over one million Americans filed for bankruptcy in 1996. Saul Hansell, *The Debt Trap*, The New York Times 1 (Aug. 25, 1996). Some people blame this trend on a loss of the "stigma" traditionally associated with bankruptcy, while others fault the credit industry for the "wave of unsolicited credit-card offers" and for prodding people to spend borrowed money. Id. For an example of this debate, see generally *Who is to Be Blamed for Credit Card Debts*, CNN Crossfire (CNN television broadcast, Dec. 29, 1996).

14. The consumer credit industry has also proposed a requirement for consumers to file bankruptcy under Chapter 13 and allow conversion to Chapter 7 only if the consumer demonstrates that he could not fund a Chapter 13 repayment plan. *Economics*, Credit Card News (cited in note 12). Further discussion of the "mandatory 13" proposal is beyond the scope of this Note.

the creditor's adherence to the credit card theories. These theories have created an imbalance in the fraud exception by focusing upon the debtor seeking discharge and disregarding the creditor claiming fraud.

This Note argues that the common law of fraud should be applied to all credit card cases under section 523(a)(2)(A). The credit card theories inadequately address the primary elements of fraud: a debtor's intent when using a credit card and a creditor's reliance when extending credit. This Note explains how the failure to properly address these elements permits card-issuers to abuse the fraud exception and to continue extending credit irresponsibly. Part II of the Note summarizes the past theories for applying the fraud exception to credit card debt. Part III describes the problems each theory has in addressing the elements of a debtor's intent and a creditor's reliance in the context of current credit card industry practices. Part IV explains how the common law of fraud improves upon the credit card theories by ensuring the availability of bankruptcy for honest debtors and elevating the importance of a card-issuer's reliance. Finally, Part V offers judicial and legislative suggestions for implementing the common law of fraud in credit card non-dischargeability actions.

II. LEGAL BACKGROUND

A. Bankruptcy and the Fraud Exception

The consumer bankruptcy system offers a "fresh start" to the "honest but unfortunate debtor" by allowing the debtor to discharge his legal obligations.[15] The discharge of debts, however, is not absolute. Several exceptions exist and these exceptions reflect Congress's intent to balance certain creditor interests with the "fresh start" policy.[16] Some creditor interests include select categories of debt, such

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15. *Local Loan Co. v. Hunt*, 192 U.S. 234, 244 (1934). See also Howard, 48 Ohio St. L. J. at 1047 n.1 (cited in note 3) (describing the history of this often cited proposition from *Local Loan Co. v. Hunt*).

16. See *Grogan v. Garner*, 498 U.S. 279, 287 (1991) ("Congress evidently concluded that the creditors' interest in recovering full payment of debts [listed in the statutory provisions governing non-dischargeability] outweighed the debtors' interest in a complete fresh start.").

as child support, alimony, certain unpaid educational loans, taxes, and liabilities for fraud.[17]

The policy underlying the fraud exception is two-fold. First, the fraud exception serves to punish "dishonest" debtors.[18] Second, the exception protects "honest" or "innocent" creditors.[19] While some have questioned the wisdom of having this provision in the Bankruptcy Code,[20] the fraud exception is deeply rooted in bankruptcy law[21] and continues to prevent debtors from abusing the "fresh start" policy. However, the improper application of the fraud exception in credit card cases permits card-issuers to abuse the Bankruptcy Code.[22]

A creditor seeking exception of a debt from discharge under section 523(a)(2)(A) must establish its claim by a preponderance of the evidence.[23] Establishing an exception is difficult, though, because courts favor granting a discharge of debts to effectuate the "fresh start" policy of the Code.[24] In 1984, Congress responded to pressure from the consumer credit industry and added section 523(a)(2)(C), the "load up" provision, which creates a presumption against discharge for certain types of debt.[25] Few cases have been decided under

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17. Id. See generally 11 U.S.C. § 523 (1994).

18. *Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985).

19. See H.R. Rep. No. 595 at 130 (cited in note 3) (noting that the purpose of the fraud exception is to protect creditors who "extended credit based on misinformation"). See also Steven H. Resnicoff, *Barring Bankruptcy Banditry: Revision of Section 523(a)(2)(C)*, 7 Bankr. Dev. J. 427, 428-434 (1990) (describing the rationale behind the fraud exception); Steven H. Resnicoff, *Dischargeability in Bankruptcy of Debts Incurred by "Purported Purchasers"*, 64 St. John's L. Rev. 255, 255 (1990) (same).

20. See Luther Zeigler, Note, *The Fraud Exception to Discharge in Bankruptcy: A Reappraisal*, 38 Stan. L. Rev. 891, 917 (1986) (arguing for the abolition of the fraud exception because it does not punish debtors, corrupts creditor conduct, and only retains a moral "intuitive appeal").

21. See *Field v. Mans*, 116 S. Ct. 437, 441, 133 L. Ed. 2d 351 (1995) (tracing the evolution of the fraud exception from earlier bankruptcy laws).

22. For a general discussion on creditor abuse of the fraud exception see Zeigler, 38 Stan. L. Rev. at 908-910 (cited in note 20).

23. *Grogan*, 498 U.S. at 288 (rejecting the "clear and convincing" standard).

24. See, for example, *In re McKinnon*, 192 B.R. 768, 771 (Bankr. N.D. Ala. 1996) ("It is well established that exceptions to discharge are to be construed narrowly against crediters, and must not be allowed to swallow the general rule favoring discharge.").

25. Under the "load up" provision, two types of debt are presumed to be non-dischargeable: (1) "consumer debts owed to a single creditor and aggregating more than $1,000 for 'luxury goods or services' incurred by an individual debtor on or within 60 days before the order for relief," and (2) "cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief." 11 U.S.C. § 523(a)(2)(C) (1994). See Nancy C. Dreher and Matthew E. Rey, *Bankruptcy Fraud and Nondischargeability Under Section 523 of the Bankruptcy Code*, 69 N.D. L. Rev. 57, 65-67 (1993) (describing the burden of proof and presumptions related to § 523(a)(2)(C)).

523(a)(2)(C),[26] however, and section 523(a)(2)(A) remains the primary battleground for credit card cases.[27]

B. Conceptual Problems in Credit Card Cases

Section 523(a)(2)(A) excepts from discharge any debt obtained by "false pretenses, a false representation, or actual fraud."[28] Courts interpret this language to require a creditor to prove five elements: (1) the debtor made representations; (2) at the time the representations were made the debtor knew they were false; (3) the debtor made the representations to deceive the creditor; (4) the creditor relied on the representations; and (5) the creditor sustained the alleged loss as the proximate result of the representations.[29] In *Field v. Mans*, a non-credit card case, the Supreme Court further refined section 523(a)(2)(A) by holding that creditors must prove *justifiable* reliance on a debtor's representations.[30] Essentially, this five-part test represents the common law of fraud.

Credit card cases have presented problems for courts applying the five-part fraud exception test because a debtor does not deal face-to-face with the card-issuer.[31] A typical credit card transaction involves a creditor's decision to extend credit to a prospective debtor and a third party's acceptance of the debtor's subsequent use of the card.

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26. See Resnicoff, 7 Bankr. Dev. J. at 440-454 (cited in note 19) (discussing the "failings" of § 523(a)(2)(C)). See also *In re Fulginiti*, 201 B.R. 730, 732-33 (Bankr. E.D. Pa. 1996) (noting the ease of overcoming the presumptions in § 523(a)(2)(C)).

27. See Dreher and Roy, 69 N.D. L. Rev. at 72 (cited in note 25) ("Probably the most typical nondischargeability case brought under subsection (a)(2)(A) is the so-called 'credit card case.' ").

28. 11 U.S.C. § 523(a)(2)(A).

29. *In re Anastas*, 94 F.3d 1280, 1284 (9th Cir. 1996). Some cases condense these five elements. See, for example, *In re Briese*, 196 B.R. at 480 (noting three essential elements of falsity, fraudulent intent, and reliance). See also Drew Frackowiak, *The Fallacy of Conflicting Theories for Analyzing Credit Card Fraud Under 11 USC Section 523(a)(2)(A)*, 4 J. Bankr. L. & Prac. 641, 642 (1995) (discussing the differences in the number of elements courts use and noting that the essentials remain the same).

30. *Field*, 116 S. Ct. 437, 444 (1995). *Field* resolved a circuit split regarding the level of reliance that a creditor needed to show to exempt a debt from discharge under the fraud exception. Section 523(a)(2)(A), on its face, does not establish a threshold of reliance, unlike § 523(a)(2)(B) which explicitly requires "reasonable" reliance. The Court held that the "actual fraud" language of § 523(a)(2)(A) requires creditors to show "justifiable" reliance. Id. at 446.

31. It is important to note that, prior to *Field*, credit card cases typically were not analyzed under this five-part fraud test. See, for example, *In re Murphy*, 190 B.R. 327, 331 (Bankr. N.D. Ill. 1995) (explaining the difficulties courts have had regarding credit card debt and the fraud exception). See also Susan Elaine Sieger, Mike Vadner, and Brian Watkins, *Survey: Fraud as an Impediment to Discharge—Denial of Discharge and Exceptions to Discharge Under the Bankruptcy Code*, 3 J. Bankr. L. & Prac. 469, 515 (1994) (noting the distinction between credit card cases and other § 523(a)(2)(A) cases).

The third party then seeks payment from the card-issuer.[32] The first conceptual problem that arises is determining what, if anything, a debtor represents to a card-issuer when purchasing items from a third party with a credit card. After establishing a representation to the card-issuer, the question then becomes how to determine whether the debtor fraudulently made that representation. Finally, this scenario forces the question: "What does a card-issuer rely upon when it extends credit?"

C. Past Theories for Analyzing the Dischargeability of Credit Card Debt

Courts have attempted to resolve the conceptual dilemmas surrounding a debtor's use of a credit card by creating different theories ("credit card theories") to evaluate the dischargeability of credit card debt under section 523(a)(2)(A).[33] Although these theories evolved from attempts to fit credit card transactions into the traditional five-part fraud test, they have become dispositive inquiries in many cases. The theories, however, do not fully encompass the two primary elements of a creditor's fraud claim: intent and reliance.

1. The Implied Representation Theory

When confronted with a creditor's claim of credit card fraud, most courts have adopted the "implied representation" theory.[34] These courts view a debtor's use of a credit card as an implied representation to the credit card company that he has both the intent *and the ability* to pay for the credit.[35] The court uses evidence of the debtor's solvency

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32. For a more detailed explanation of the tripartite credit card system, see Henry H. Perritt, Jr., *Legal and Technological Infrastructures for Electronic Payment Systems*, 22 Rutgers Computer & Tech. L. J. 1, 20-24 (1996). Also, see generally, Barkley Clark, *The Law of Bank Deposits and Credit Cards*, ¶11.01-.02 (Warren, Gorham, & Lamont, 3rd ed. 1990).

33. See *In re Briese*, 196 B.R. at 446 ("[C]ourts have crafted several theories to support nondischargeability judgments in credit card cases."). One commentator contends that distinguishing these theories is almost irrelevant because courts often use objective factors to determine a cardholder's intent. Frackowiak, 4 J. Bankr. L. & Prac. at 641 (cited in note 29). Frackowiak provides good background and descriptions for each credit card theory, but his argument is superficial. It assumes that courts use these theories only to overcome conceptual problems regarding a debter's representations and intent. As such, his argument completely ignores reliance.

34. See *In re Wong*, 207 B.R. 822 (Bankr. E.D Pa. 1997) (adhering to "majority" implied representation theory); *In re Briese*, 196 B.R. at 446 (noting that the implied representation theory is the majority approach); *In re Cox*, 182 B.R. 626, 633 n.23 (Bankr. D. Mass. 1995) (citing cases adhering to the implied representation theory).

35. *In re Briese*, 196 B.R. at 446. There is a slight discrepancy as to whether both intent and ability to pay are impliedly represented upon credit card usage. See Frackowiak, 4 J. Bankr.

or insolvency at the time the debtor used the credit card to determine whether this representation was fraudulent.[36] While created to address the element of representation in a creditor's fraud claim, this test reduces the five-part fraud analysis solely to an inquiry into the debtor's intent. This inquiry alone determines whether credit card debt should be excepted from discharge.[37]

2. The Assumption of Risk Theory

A few courts follow the Eleventh Circuit's "assumption of risk" approach which is less favorable to creditors than the implied representation theory.[38] Under this theory, a card-issuer bears the loss of non-payment from any credit card debt unless the issuer revokes the card-holder's privileges with notice before the charges are incurred. This theory presupposes the inherent risk of nonpayment in credit card transactions which is "factored into the finance charges."[39] Because card-issuers assume this risk, they may recover for fraud only when a debtor uses his credit card after revocation.[40]

3. The Totality of the Circumstances Theory

Finally, many courts follow a "totality of the circumstances" or "objective test" theory.[41] This is perhaps the most vague test. Under

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L. & Prac. at 646-647 (cited in note 29) (noting that majority of cases recognize that ability to pay is represented with intent to pay). But see *In re Lippert*, 206 B.R. 136, 139 (Bankr. N.D. Ohio 1997) (noting that recent cases have limited implied representation to card-holder's intent to pay).

36. *In re Cox*, 182 B.R. at 633.

37. See Frackowiak, 4 J. Bankr. L. & Prac. at 646 (cited in note 29) ("The term 'implied representation' has been expanded into a complete theory of credit card fraud analysis."). See, for example, *In re Van Dyke*, 205 B.R. 587, 589 (Bankr. W.D. Mo. 1997) (finding a debt non-dischargeable because debtor "knew he was without such ability [to repay the debt], and, as a result, intended to deceive" the creditor, without an analysis of the creditor' reliance when debtor received credit card with a $5000 limit at nearly the same time he became unemployed).

38. This approach originated in *First Nat'l Bank of Mobile v. Roddenberry*, 701 F.2d 927 (11th Cir. 1983). In *Roddenberry*, the debters owned joint credit cards and exceeded their credit limit. Despite several warnings from the bank, the debtors continued to use their credit cards, primarily because they became separated and one of them indulged in a spending spree. Eventually the bank authorized the revocation of the debtors' cards. Id. at 928-29.

39. Id. at 932.

40. Id.

41. *In re McKinnon*, 192 B.R. at 773. One scholar has referred to this approach as the "actual fraud test" and advocated this theory for its "flexibility." Resnicoff, 64 St. John's L. Rev. at 276, 286 (cited in note 19). Resnicoff, however, failed to describe how the theory encompasses all the elements of fraud.

this theory, courts focus on a creditor's ability to prove that a debtor used a credit card without intending to repay the card-issuer. A debtor's fraudulent intent is inferred by applying a list of factors to the particular case.[42] Courts utilize these factors to find either that a debtor intended to defraud the creditor, *or* that a debtor should have realized that he would not be able to pay for the credit extended.[43] This theory modifies the "assumption of risk" theory by evaluating pre-revocation credit card charges under the "totality" test to determine if they were fraudulently incurred and are thus non-dischargeable.[44]

D. *The Common Law of Fraud Applied to Credit Card Cases*

The "common law of fraud" approach seeks to avoid the legal fictions, such as implied representations and inferences from objective factors, of the other theories by distinctly addressing each element of fraud for a section 523(a)(2)(A) claim.[45] Under the common law of fraud, a debtor's use of a credit card is only a representation of his present intent to pay for the credit extended.[46] This representation is

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42. The common list of factors of the objective test theory is:

> (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 (12) Whether the purchases were made for luxuries or necessities.

In re Dougherty, 84 B.R. 653, 657 (9th Cir. B.A.P. 1988) (citing *In re Faulk*, 69 B.R. 743, 757 (Bankr. N.D. Ind. 1986)).

43. The Ninth Circuit maintains that the 12 factors are used "to establish the subjective intent of the debtor. . . ." *In re Eashai*, 87 F.3d 1082, 1090 (9th Cir. 1996). However, objective factors impede this determination and basically create a reasonableness standard for evaluating a debtor's intent. *In re McKinnon*, 192 B.R. at 773. See also *In re Alvi*, 191 B.R. at 733 (noting that use of factors detracts from the subjective analysis because one cannot distinguish which factors are weighted more than others); Frackowiak, 4 J. Bankr. L. & Prac. at 650-54 (cited in note 29) (arguing for a reasonableness standard as the natural result of cases applying objective factors).

44. *In re Dougherty*, 84 B.R. at 657.

45. *In re Briese*, 196 B.R. at 450. The common law approach was precipitated by the Supreme Court's 1995 decision in a non-credit card case, *Field*, 116 S. Ct. at 437. In determining that § 523(a)(2)(A) required creditors to prove justifiable reliance because of the phrase "actual fraud," the Court stated that "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." Id. at 444 (citations omitted).

46. *In re Briese*, 196 B.R. at 50-51 (citatious omitted); *In re Murphy*, 190 B.R. at 332.

actionable as fraud if the debtor did not intend to honor it when it was made.[47] To determine whether a debtor's intent was fraudulent, courts use a subjective standard that focuses upon the debtor's state of mind at the time of the representation.[48] In addition, creditors must prove that their reliance upon the debtor's representation was justifiable.[49]

The use of the common law of fraud in credit card non-dischargeability actions presents several concerns. First, courts have not universally applied the common law of fraud to credit card cases.[50] Also, the credit card industry has criticized this approach because it requires creditors to prove such a high level of reliance.[51] Lastly, the common law of fraud's *subjective* evaluation of a debtor's intent conflicts with the consumer credit industry's current proposal to expand the fraud exception to include debts incurred without a *reasonable* expectation of repayment.[52] Nonetheless, the common law of fraud resolves numerous problems and shortcomings of the alternative credit card theories.

III. PROBLEMS WITH THE CREDIT CARD THEORIES

As noted by the court in *In re Briese*, the common law of fraud resolves several troubling aspects of the other credit card theories.[53] These problems primarily relate to how each theory examines (or neglects) the debtor's intent and the creditor's reliance (or lack

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47. *In re Briese*, 196 B.R. at 145 (citing *In re Murphy*, 190 B.R. at 332). See also Restatement (Second) of Torts § 530(1) (1976) ("A representation of the maker's own intention to do or not to do a particular thing is fraudulent if he does not have that intention.").

48. *In re Murphy*, 190 B.R. at 332. It is "inappropriate" to find that a reasonable cardholder could not have intended to pay for credit. Id. at 333. Instead, courts must determine that particular debtor's intent. Id.

49. While the *Murphy* court's opinion is one of the first decisions using the common law approach, it did not address the element of justifiable reliance. Id. at 331 n.4. The definition of justifiable reliance is still in flux and will be discussed further in Part IV.B.1.

50. See, for example, *In re Leventhal*, 194 B.R. 26, 28 (Bankr. S.D.N.Y. 1996) (denying a motion to dismiss under the "totality of the circumstances" theory and noting that courts do not need to apply "the classic five elements" of fraud); *In re Willis*, 190 B.R. 866 (Bankr. W.D. Mo. 1996) (using the justifiable reliance standard but examining the debtor's intent under an objective test). See also Gorman, *Rethinking Credit Card Fraud* at 4-5 (cited in note 9) (analyzing how courts applying the common law of fraud reach different results).

51. See note 11.

52. See note 12 and accompanying text (discussing preposal).

53. *In re Briese*, 196 B.R. 440, 449 (Bankr. W.D. Wisc. 1996). The *Briese* court also noted that "[t]he emerging consensus appears to be that none of the approaches fully explains or resolves the issue of a debtor's fraudulent use (or abuse) of a credit card." Id. at 448.

thereof) in a credit card transaction.[54] Current industry practices[55] exacerbate these problems and necessitate a new approach for section 523(a)(2)(A) credit card cases which focuses on whether creditors were truly deceived by cardholders and thereby induced into extending credit.[56]

A. Inadequate Analysis of a Debtor's Intent

Each of the credit card theories fails to accurately analyze a debtor's intent and, therefore, produces undesirable results. The implied representation theory relieves card-issuers from proving a debtor's fraudulent intent. This approach condones the credit card industry's tactics of exploitation which drive debtors into bankruptcy.[57] The totality of the circumstances theory, with its list of factors and objective analysis of a debtor's intent, also significantly favors card-issuers.[58] Finally, the assumption of risk theory inexplicably disregards the element of intent and exposes card-issuers to increased losses from fraud.[59] Overall, all the theories permit card-issuers to transform the fraud exception from a means of redressing harm caused by deceptive debtors into a collection device.

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54. Most courts agree that the use of a credit card satisfies the representation element of a fraud claim. See Frackowiak, 4 Bankr. L. & Prac. at 646 (cited in note 29) (noting that "there is little dispute that a cardholder does make a representation when he uses his credit card"). The only problem lies within the content of the representation which is an issue of the debtor's intent. But see *In re Alvi*, 191 Bankr. at 731 ("The use of a credit card to incur debt in a typical credit card transaction involves no representation, express or implied."); *In re Cox*, 182 B.R. at 634-36 (same). See also *In re Feld*, 203 B.R. 360, 366 (Bankr. E.D. Pa. 1996) (noting that giving a "literal effect to the statute would be to except credit card transactions from the reach of § 523(a)(2)(A)," but declining to follow such cases as *In re Alvi* and *In re Cox* which might "insulate a debtor who fraudulently uses a credit card").

55. See Parts III.A.1 and III.B.3.

56. Professor Frackowiak has proposed a "simple, one-prong test: ... Did the debtor have an intent to deceive the credit card company at the time the card was used?" Frackowiak, 4 J. Bankr. L. & Prac. at 654 (cited in noto 29). Frackowiak maintains that "the elements of representation and damages can be logically assumed" and argues that his test avoids addressing the level of reliance required by a creditor, an issue subsequently resolved by the Supreme Court in *Field*. Id. at 654 n.109. Because it ignores the element of reliance, this test is flawed. Professor Frackowiak recently argued his position before the United States Bankruptcy Court for the District of Nebraska. He represented, not surprisingly, a credit card-issuer. See *Matter of Hiemer*, 184 B.R. 345 (Bankr. D. Neb. 1995). Ironically, the court found the argument of the card-issuer "misplaced," partially because the card company had issued the debtor a pre-approved credit card while he was in "extensive" debt and after he had been turned down by another card-issuer. Id. at 348.

57. See Part III.A.1.

58. See Part III.A.2.

59. See Part III.A.3.

1. Preferring Card-Issuers under the Implied Representation Theory

Courts following the implied representation theory concentrate on finding a "false representation" at the expense of analyzing a debtor's intent. Because courts perceive the use of the credit card as an implied representation of the debtor's intent *and ability* to pay for the charges, a debtor risks becoming a "guarantor" of his financial condition to a credit card-issuer.[60] Courts have equated a breach of this guarantee, such as not having enough money to pay for the charges when the card was used, with the fraudulent intent necessary to except the debt from discharge.[61]

This rationale disregards the realities of credit card uses. People often purchase items with credit cards because they do not have the ability to pay at that time.[62] Such a transaction does not necessarily mean that a debtor lacks *intent* to pay for the purchases.[63] Furthermore, in ascertaining a debtor's ability to pay for credit, courts do not account for the debtor's ability to pay the minimum payments required by the card-issuer.[64] In other words, courts fail to consider, for example, that a debtor who incurs $2,500 in charges may need to pay only $50 within one month.[65] Card-issuers do not claim fraud when debtors purchase items and make only minimum payments. In fact, this behavior fuels the credit card industry's profits.[66]

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60. *In re Briese*, 196 B.R. at 448.

61. See *In re Cox*, 182 B.R. at 633 (describing how courts infer fraud from a debtor's inability to pay).

62. See *In re Murphy*, 190 B.R. at 332 ("One of the principle reasons people rely on credit is a present lack of ability to pay."). The practice of paying for items on credit without the present ability to pay for them is becoming more prevalent. Consumers are now spending $1.10 for every $1 increase in income. Delinquency on Consumer Loans, Federal News Service (cited in noto 4) (statement of Lawrence Lindsey, Governor, Federal Reserve Board). While spending beyond one's means is imprudent, it should not be classified as fraudulent.

63. One could conceive of numerous situations in which a debtor is unable to pay for charges at the time they were made yet still intended to repay. One scholar analogized spending to drug or alcohol addictions and described several organizations that help consumers with spending problems. Ritzer, *Expressing America* at 78-81 (cited in note 4).

64. *In re Cox*, 182 B.R. at 633.

65. Minimum monthly payments typically range from 2% to 5% of the total balance. Ritzer, *Expressing America* at 85 (cited in note 4). However, a $2,500 balance at an annual percentage rate of 18.5% would take 30 years to pay off with minimum payments of 2%. Id. at 95. Therefore, though a debtor may intend to pay off such a balance, the reasonableness of a card-issuers' reliance upon promises to repay is questionable as they only encourage minimum payments. See Part IV.B (discussing the "justifiable reliance" standard).

66. See note 2 and accompanying text.

The failure to address a debtor's fraudulent intent as a distinct element[67] of a credit card company's section 523(a)(2)(A) fraud claim bestows a preferential status upon card-issuers. Other creditors must prove each and every element of a non-dischargeability claim.[68]

Of course, simply making credit available does not cause bankruptcy or fraud. Card-issuers, however, engage in deceptive practices that may affect a debtor's ability to pay for credit without affecting his intent to pay. For example, card-issuers offer low introductory interest rates, or "teaser rates," which are temporary and induce unwilling card-holders into obligations to pay higher rates.[69] Also, the calculation of the interest rates in conjunction with various late fees may result in rates higher than those advertised.[70] Another deceptive tactic is the "payment holiday" that encourages debtors to skip a month's payment while heavy finance charges continue to accrue.[71] Even the minimum payment requirement in this scheme is misleading because it does not advise consumers how long it will take to pay off their balances.[72] Finally, the credit card companies run various advertising campaigns to encourage spending.[73]

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67. Though mainly a concern when courts use the "implied representation" theory, the diminished analysis of a debtor's actual intent as a distinct element also surfaces when courts apply the "totality of the circumstances" theory. In other words, by listing a set of factors designed to determine a debtor's intent, some courts may decide cases based solely upon these factors without actually relating them to the specific element of a debtor's fraudulent intent. See *In re Anastas*, 94 F.3d at 1286 (recognizing the danger of the 12 facter test becoming "a substitute for an actual finding of bad faith").

68. *In re Briese*, 196 B.R. at 448-49. See also *In re Hashemi*, 104 F.3d 1122, 1122 n.1 (9th Cir. 1996) ("The outcome of this action will affect other creditors of the bankruptcy estate by drawing money from the pool of assets available to satisfy the debtor's obligations . . . affect[ing] the restructuring of the debtor's relationship with other creditors."). Such a distinction becomes especially problematic when a debtor may have filed for bankruptcy because of becoming overextended due to the ease of obtaining credit. According to a recent Visa U.S.A. survey, most people cited excessive spending as the main reason for filing for bankruptcy. Hansell, The New York Times at 1 (cited in note 13).

69. Ritzer, *Expressing America* at 96 (cited in note 4). These "teaser rates" are often as low as 5.9-8.9% for a number of months and then are increased to approximately 16-17%. Ausubel, 70th Annual Meeting of the Natl. Conference of Bankr. Judges at 8-13 (cited in note 2).

70. Ritzer, *Expressing America* at 94-96 (cited in note 4). For example, the mere compounding of interest results in a real interest rate of 19.56% when the published rate is 18%. Id. at 95. Overall, card-issuers generated an estimated $3.1 billion from "hidden fees" in 1995. Ausubel, 70th Annual Meeting of the Natl. Conference of Bankr. Judges at 8-13 (cited in note 2). The concern over deceptive interest rates led Rep. Schumer to introduce legislation requiring credit card companies to print in large type the "true interest" rate. Eda Galeno, *Low Rates? Bill Explains Credit Cards Fine Print*, Newsday A16 (Oct. 21, 1996).

71. Ritzer, *Expressing America* at 95 (cited in note 4).

72. Id. Congress once considered requiring this information on credit card billing statements, but the movement failed. Id. at 104.

73. See *In re McDaniel*, 202 B.R. 74 (Bankr. N.D. Tex. 1996) (deeming the bank's practice of unilaterally raising credit limits and providing "Access Checks" to consolidate credit card debt to be "commercial entrapment").

In light of these industry practices, card-issuers should have to prove a debtor's fraudulent intent without relying on a debtor's insolvency at the time the card was used. Failure to require such proof from credit card companies effectively condones their deceptive practices that may lead debtors into bankruptcy. Furthermore, the implied representation theory is inequitable, as it allows card-issuers the greatest chance among creditors to attain an exception from discharge.[74]

2. Penalizing Card-Holders under the Totality Test

Unlike the implied representation theory, the totality of the circumstances theory specifically requires card-issuers to prove a debtor's fraudulent intent. This theory is flawed, however, due to its significant bias toward card-issuers. The bias results from a list of factors and an objective analysis used to determine a debtor's fraudulent intent.

The totality of the circumstances test attempts to overcome difficulties in proving a card-holder's fraudulent intent[75] by applying a list of factors to the particular case.[76] Its title notwithstanding, the "totality" test does not account for all relevant facts. Instead, the theory prescribes a more narrow approach favoring credit card companies. The theory directs courts to look for elements indicating a debtor's fraudulent intent and not for any mitigating factors.[77] Potential mitigating factors include a debtor's offer to settle with the card-issuer, maintenance of minimum payments, and the effect of an unexpected financial crisis. Each of these factors may influence courts

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74. See Zeigler, 38 Stan. L. Rev. at 907 (cited in note 20) ("[I]t is inequitable to reward a possibly imprudent creditor who failed to detect the debtor's misrepresentation by excepting her debt from discharge, while the dehtor's other, more prudent creditors have their claims evaluated collectively."). This commentator concluded that the fraud exception reduced the level of investigation and thus encouraged debtors to overextend themselves. Id. While it is questionable that a mere lack of initial investigation causes overextension, it is clear that the deceptive practices of the credit card industry do encourage and facilitate excessive spending.

75. See, for example, *In re Briese*, 196 B.R. at 451 ("It is of course difficult, if not impossible, for a plaintiff to present direct evidence of a debtor's intent to deceive."). Presumably the difficulty results from the lack of contact between the two parties.

76. See note 42 (listing 12-factor test).

77. Courts applying the 12 factors of the totality test often mention that the list of factors is non-exclusive. See, for example, *In re Dougherty*, 84 B.R. at 657. This disclaimer, however, does not eliminate the bias behind this approach and the risk that some courts will weigh the listed factors more heavily than others.

to hold that a debtor did not intend to defraud a credit card company despite the existence of other objective factors.[78]

Underlying the "totality" test is the idea that a reasonable person standard should govern a debtor's use of credit cards.[79] The consumer creditors' proposal regarding the fraud exception expressly incorporates this reasonableness requirement.[80] A problem arises, however, when courts try to determine the reasonable use of a credit card. After all, some people might consider it reasonable to purchase items while intending to pay only the minimum monthly balance. Others may think it unreasonable to carry any balance on a credit card. Credit card-issuers often prefer the former over consumers who use their credit card and pay their entire balance.[81]

In addition, evaluating credit card expenditures under a reasonableness standard seems antithetical to the liberal policies of the "fresh start" in the Bankruptcy Code. By excepting from discharge "unreasonable" credit card debt, courts may restrict the availability of bankruptcy too much. As one court has observed, "nearly all bankruptcy debtors . . . incurred debt at a time when they had an objective inability to pay."[82] Also, one must consider that many unsophisticated debtors use credit cards.[83] These debtors may lack "reasonable" financial judgment but should not be considered perpetrators of fraud. Furthermore, card-issuers have facilitated and encouraged the use of

78. See, for example, *In re Anastas*, 94 F.3d at 1287 (noting that debtor's attempt to structure an alternative payment plan while making monthly payments was inconsistent with an intent to incur debt without repaying); *Matter of Hiemer*, 184 B.R. at 347 (finding debtor maintained minimum payments after incurring the last charge and until filing bankruptcy); *In re Valdes*, 188 B.R. 533 (Bankr. D. Md. 1995) (finding debtor incurred unforeseen medical and automobile expenses).

79. See *In re McKinnon*, 192 B.R. at 773 ("[I]n essence, the totality of the circumstances theory adopts the 'reasonable man' test. . . ."). See also note 43 (same).

80. See note 12 and accompanying text (discussing proposal).

81. Card-issuers discourage "convenience users," consumers who pay off their balance each month. For example, General Electric implemented a $25 annual charge for customers who do not carry a balance on their account and who incur less than $25 in annual finance charges. Patrick Loe, *GE to Tack on $25 Fee to Cardholders Who Pay Off Their Balances Promptly*, Los Angeles Times D1 (Sept. 11, 1996).

82. *Matter of Hiemer*, 184 B.R. at 347. See also *In re Karelin*, 109 B.R. 943, 948 (9th Cir. B.A.P. 1990) (noting that "debtors incur debts with hopes of repaying them that could be considered unrealistic in hindsight").

83. See, for example, *In re Merritt*, 1997 Bankr. LEXIS 747 (Bankr. M.D. Fla. 1997), in which a credit card was issued to a 33-year old witb an eighth-grade education. See also Filipow, 58 Ind. L. J. at 332 (cited in note 3) (describing consumers' lack of financial sophistication). See also Ritzer, *Expressing America* at 12-15 (citod in note 4) (describing aggressive methods of soliciting college students who often have not been educated in handling credit responsibly).

credit cards to purchase necessities.[84] Determining the reasonableness of such purchases is problematic to say the least.

Finally, imposing a reasonableness standard could effectively penalize card-holders for utilizing a credit card instead of another form of loan. The penalty is that debtors may make only reasonable investments to obtain a discharge and a complete fresh start. In essence, credit card-issuers are compensating for their lack of inquiry regarding debtors by asking courts to hold card-holders to a higher standard of care. The use of a credit card instead of financing should matter little regarding the debtor's intent to pay for the credit extended.[85] Evaluating credit card debtors under an objective standard, though, increases judicial evaluation of an individual's investment choices rather than allowing creditors to make such evaluations before extending credit. This analysis detracts from any honesty and the actual intent of the debtor.

3. Disregarding a Debtor's Intent under the Assumption of Risk Theory

Contrary to both the implied representation and totality of the circumstances theories, the assumption of risk theory detrimentally affects credit card-issuers. While accounting for the deceptive practices of the credit card industry, the theory entirely disregards the truly dishonest card-holder who defrauds a card-issuer.[86] This disregard for the debtor's intent proves troublesome because it permits a debtor to commit fraud without repercussions until a card-issuer discovers the fraud and revokes the debtor's credit card. Some courts also have suggested that this test misplaces the focus of the fraud exception on the "improvident creditor."[87] This point is tenuous considering the methods card-issuers use to increase debt spending,

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84. See Ritzer, *Expressing America* at 82 (cited in note 4) (calling for credit card industry to stop inducing people to buy essentials with credit cards). Classifying tbe purchase of necessities as an exception to discharge attenuates the principles of fraud when the card-holder still intends to pay for tbe credit extended. See, for example, *In re Valdes*, 188 B.R. at 539 ("All but one of the [debtor's] purchases were for necessities.").

85. For an example of cases where credit cards were used to finance business activities see *In re McKinnon*, 192 B.R. at 768 (incurring credit card debt to finance a book on the history of the Russian space program); *In re Bermingham*, 201 B.R. 808 (Bankr. W.D. Mo. 1996) (incurring credit card debt in furtherance of "free-lance sculptor" work in preparation for a convention). In both cases, the debts were declared non-dischargeable under a subjective analysis of each debtor's intent to repay the debt.

86. See *In re Briese*, 196 B.R. at 449 (noting room for manipulation by dishonest debtors).

87. *In re Dougherty*, 84 B.R. at 657.

but the injustice of barring a creditor from recovering losses if it can prove a debtor's fraudulent intent and justify its reliance on the debtor's representations.

4. Overall Bias Encourages Frivolous Lawsuits

As demonstrated, all of the credit card theories inadequately analyze a debtor's intent when using a credit card. Because most courts follow either the implied representation theory or the totality of the circumstances theory, judicial analysis of credit card fraud under section 523(a)(2)(A) has favored card-issuers. Continued analysis under these theories improvidently expands the fraud exception into a collection device for credit card companies.

The mere existence of the fraud exception provides credit card-issuers considerable leverage over card-holders.[88] This leverage permits card-issuers to obtain settlements outside of the bankruptcy process on what may often be dischargeable debt.[89] By not forcing credit card companies to clearly establish a debtor's actual fraudulent intent, courts provide more leverage to card-issuers by facilitating successful "fraud" actions. Thus, the fraud exception may become another step for card-issuers in the collection process before they classify debts as uncollectible.

As bankruptcies increase, courts can expect more fraud claims based solely on a card-issuer's mechanical analysis of the totality test's factors.[90] The failure to adequately analyze a debtor's intent when using a credit card encourages creditors to bring fraud claims without any prior investigation.[91] As a result, the number of meritless

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88. See Zeigler, 38 Stan. L. Rev. at 910 (cited in note 20) ("Moreover, creditors can exploit the exception without going to court; often the mere *threat* of a fraud action will convince a debtor to pay off a debt or to enter into a reaffirmation agreement.").

89. See, for example, *In re Bermingham*, 201 B.R. at 815-16 (noting incentives of both parties to settle dischargeability proceedings, thus requiring greater scrutiny into consent judgments because they may saddle debtors with obligations they are unable to pay); *In re Grayson*, 199 B.R. 397 (Bankr. W.D. Mo. 1996) (same).

90. The rote application of these factors by credit card-issuers expecting exception without inquiry into a debtor's actual intent is exemplified in *In re Chinchilla*, 202 B.R. 1010 (Bankr. S.D. Fla. 1996). The court imposed attorney's fees and costs against the creditor, AT&T Universal Card Services Corp., because the creditor's allegations of fraud were not "substantially justified." Id. at 1017. The court noted that AT&T relied upon the *Dougherty* factors in basing its fraud claim, but these factors "[did] not come close to presenting a picture of deceptive conduct," primarily because AT&T did not investigate its claim prior to filing. Id. at 1018 (citation omitted). Such investigation would have revealed a "critical fact": The debtor's spouse had become disabled, and as a result unemployed, after the alleged fraudulent credit card purchases and that is what caused the bankruptcy. Id. at 1017.

91. See, for example, *In re Grayson*, 199 B.R. at 397 (awarding attorney's fees against a credit card company in two suits because of failure to examine debtors before bringing suit, one

claims creditors bring will likely increase the wasting of judicial resources.

B. Failure to Analyze a Card-Issuer's Reliance

Courts have found that reliance is the most difficult of the 523(a)(2)(A) standards to apply to credit card transactions.[92] As a result, courts have largely ignored card-issuers' reliance upon a debtor's representation in credit card fraud cases.[93] Although the Supreme Court has established the justifiable reliance requirement for claimants under section 532(a)(2)(A),[94] the credit card theories do not ensure proper use of this standard.[95] Considering current credit

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of which it later tried to dismiss upon contestation by the debtor); *In re Stansel*, 203 B.R. 339, 344 (Bankr. M.D. Fla. 1996) (awarding attorney fees against a credit card company for failing to investigate its § 523(a)(2)(A) claim).

92. *In re Feld*, 203 B.R. at 368. See also Daniel R. Cowans, 2 Bankr. L. & Prac. § 6.29 (West, 6th ed. 1994) ("The issuance of credit cards to a debtor raises new problems in terms of reliance.").

93. The analysis of reliance has also been scant in academia. See, for example, Resnicoff, 64 St. John's L. Rev. at 274 (cited in note 19) ("There is no theoretical basis for characterizing as unreasonable a card-issuer's roliance on a debtor's initial intent to pay."); Dreher and Roy, 69 N.D. L. Rev. 57 (cited in note 25); Resnicoff, 7 Bankr. Dev. J. at 463 n.166 (cited in note 19) (recommending extension of § 523(a)(2)(C) time periods and a per se denial of discharge if creditors prove that "no reasonable debter could reasonably have expected te pay the debt without failing to pay his other debts" and dismissing criticism of creditors' lending practices); Frackowiak, 4 J. Bankr. L. & Prac. at 642 (cited in note 29) ("Fortunatoly, the issue of reliance is not a subject of this article.").

Some commentators have addressed the reliance concerns. For the most thorough discussion, see generally Filipow, 58 Ind. L. J. at 319 (cited in note 3). It is important to realize that the Filipow Note predates the advent of the credit card theories because to address the relianco concerns of credit card-issuers, one must first resolve the problems of how courts are currently handling these cases. Also, Filipow speaks of acquiescence as a defense to a creditor's claim rather than addressing the element of reliance as an integral part of that creditor's claim. While a seemingly small distinction, more emphasis placed on reliance to prove a fraud claim may deter meritless claims and prevent the need to defend them by claiming that a creditor acquiesced. Finally, Filipow disagrees with the "balancing appreach, [of] weighing the culpability of the debter and the creditor. . . ." Id. at 334. Filipow argues instead for more "responsibility" on the creditor to prevent credit card abuse. Id. As it turns out, the Note more or less advocates the "assumption of risk" theory. This theory is not the solution to problems with the fraud exception, however. Instead, the balance of intorests is essential and must be restored. See also Zeigler, 38 Stan. L. Rev. at 908-10 (cited in note 20) (addressing creditor abuse of the fraud exception).

94. *Field*, 116 S. Ct. at 446.

95. Not only is it unclear whether principles of justifiable reliance can co-exist with the past credit card theories, but apparently not all courts have utilized the justifiable reliance standard in credit card cases. See, for example, *In re Burns*, 196 B.R. 11 (Bankr. W.D.N.Y. 1996) (not mentioning *Field* or justifiable reliance); *In re Haji*, 201 B.R. 176 (E.D. Mich. 1996) (same); *In re Berry*, 197 B.R. 382, 383 (Bankr. M.D. Fla. 1996) (declining summary judgment without reference to relianco despito noting the "pre-approved unsolicited" credit card). See also note 50.

card industry practices, the inconsistent treatment of a card-issuer's reliance in fraud claims cannot continue.[96]

1. Foreclosing Reliance under the Assumption of Risk Theory

The assumption of risk theory, the minority approach among the credit card theories,[97] attempts to address the reliance concerns involved in credit card transactions. For example, the court in *First National Bank of Mobile v. Roddenberry*[98] properly questioned whether a card-issuer relied on any debtor representations regarding repayment of charges. The court noted that banks factor the non-payment of debts into their finance charges. A conceptual problem arises: How can a card-issuer claim that a card-holder's non-payment deceived the issuer when it expects some people to default?

By establishing a bright-line standard denying recovery absent revocation of the debtor's credit card, the assumption of risk theory forecloses the possibility of a card-issuer establishing any reliance. No matter how closely a card-issuer investigates debtors prior to issuing a credit card or how closely the issuer monitors its accounts, the issuer will fail to recover pre-revocation fraudulent charges.[99] This result is particularly troubling in light of a recent Ninth Circuit case where a card-holder engaged in a deliberate credit card "kiting" scheme.[100] In such cases, the most careful creditor may fail to detect the fraud before incurring substantial losses.[101] Denying recovery to a creditor able to prove his own "innocence" as well as the debtor's "dishonesty" does not advance the policies behind the Bankruptcy Code or the fraud exception.

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96. See Part III.B.3 (discussing current industry practices).

97. See, for example, *In re Wong*, 207 B.R. at 822.

98. 701 F.2d 927, 932 (11th Cir. 1983). The *Roddenberry* court also noted that "banks have a definite interest in permitting charges beyond established credit limits because of the high finance charges typical in such transactions." Id.

99. *In re Dougherty*, 84 B.R. at 656. See also *In re Shanahan*, 151 B.R. 44, 47 (Bankr. W.D.N.Y. 1993) (noting tbat card-issuers do not assume the risk of fraud).

100. *In re Eashai*, 87 F.3d at 1082. The debtor owned 26 credit cards and used cash advances from some cards to maintain minimum payments on the others until he depleted his credit limits by amassing over $100,000 in unsecured debt. Id. at 1085-86.

101. The "kiting" scheme clearly disturbed the *Eashai* court because no "red flags" would warn the creditor of the fraud. Id. at 1091. However, the court focused on this point to the exclusion of the fact that the creditor awarded a $20,000 credit line to a debtor whose yearly income was around $24,000. See text accompanying note 150 (discussing required showing of reliance under justifiable reliance standard). Nonetheless, this "kiting" scheme raises legitimato concerns for any creditor.

2. Neglect and Confusion in Analyzing Reliance under the Implied Representation and Totality of the Circumstances Theories

Most courts do not follow the assumption of risk theory, and, as a result, they often disregard any proof of a card-issuer's reliance in section 523(a)(2)(A) credit card cases. Similar to the assumption of risk theory, other credit card theories disregard the need to prove card-issuers' reliance. For example, the implied representation theory allows credit card companies to imply reliance.[102] Ironically, despite its development from criticism of the implied representation theory's inferences, the totality test does not specifically address the element of reliance either.[103] In fact, the totality test lists only factors to help establish a debtor's intent but offers none regarding the element of a creditor's reliance.[104]

Besides flaws within the credit card theories themselves, a circuit split regarding the level of reliance required in section 523(a)(2)(A) actions[105] has contributed to the absence of a uniform method for analyzing a card-issuer's reliance. Courts requiring creditors to demonstrate only actual reliance have more or less disregarded the reliance element of their fraud claim.[106] Presumably, a card-issuer satisfies actual reliance by merely paying the merchant for the credit extended. In this context, some courts have addressed reliance problems under the guise of intent as illustrated by the court in *In re Sigrist*.[107]

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102. See *In re Murphy*, 190 B.R. at 331 n.4 ("Many courts also created an implied reliance theory.").

103. See *In re Dougherty*, 84 B.R. at 656 (criticizing the implied representation theory but noting that, "[i]n third party credit card transactions, . . . the concepts of representation and reliance have little meaning"). See also *In re Cox*, 182 B.R. at 637 (citing *In re Dougherty* as an example of courts that "state reliance is necessary and then ignore the requirement altogether"); *In re Akdogan*, 204 B.R. 90, 96 n.4 (Bankr. E.D.N.Y. 1997) (stating that the "totality" test "spurn[s] all notion of adherence to the traditional five elements of fraud").

104. Compare *In re Dougherty*, 84 B.R. at 657 (listing 12-factor test), with *In re Kahler*, 187 B.R. 508, 514 (Bankr. E.D. Va. 1996) (non-credit card case citing factors to determine a creditor's reasonable reliance).

105. See *Field*, 116 S. Ct. at 445 (describing the circuit split on the level of reliance).

106. See, for example, *In re Hinman*, 120 B.R. 1018, 1022 (Bankr. D.N.D. 1990) ("Reliance on the part of the issuer is inherent in the system. . . .").

107. 163 B.R. 940 (Bankr. W.D.N.Y. 1994). See also *In re Burns*, 196 B.R. at 12-14 (following *Sigrist*); *In re Davis*, 176 B.R. 118, 120 n.2 (Bankr. W.D.N.Y. 1994) ("[I]ndustry practices are relevant in assessing consumer expectations and the *intent* behind conduct. . . ." (emphasis added)). Additionally, courts have questioned credit card companies' practices without relating these concerns to any part of the fraud test. See, for example, *In re Hiemer*, 184 B.R. at 348 (noting that the debtor received a pre-approved credit card while having "extensive" debt on 17 other credit cards but not describing any effect on the issuer's reliance).

In *Sigrist* a bank issued a "pre-approved" credit card to an insolvent debtor. Under the totality of circumstances theory, the court held that the plaintiff's decision to lend to an insolvent debtor disallowed any inference of fraud based on the insolvency.[108] The *Sigrist* court did not mention the effect of the card-issuer's actions on the legitimacy of its reliance upon the debtor's represented intent to pay.[109]

The courts that require "reasonable" reliance under section 523(a)(2)(A) consider more carefully whether a card-issuer relied upon a card-holder's representations when extending credit. Most reliance problems relate to the card-issuer's practice of distributing "pre-approved" credit cards. The Sixth Circuit's decision in *In re Ward* remains the leading case regarding this problem. In *Ward*, a credit card company issued a pre-approved credit card without conducting a credit check on a debtor who was in debt on twelve other credit accounts and had once been convicted of embezzlement.[110] The *Ward* court modified the *Roddenberry* assumption of risk theory by holding that a credit check must be conducted at some point; otherwise, an exception to discharge is unavailable.[111] Some courts follow *Ward* and require credit card-issuers to carefully analyze debtors' credit histories when issuing "pre-approved" cards.[112] Other decisions indicate that reasonable reliance entails monitoring the account in question.[113] Despite these examples of thorough inquiry into a card-issuer's

108. *In re Sigrist*, 163 B.R. at 949.

109. In fact, the *Sigrist* court previously noted that "the reasonableness or unreasonableness of the lender's decision to lend is totally irrelevant" to its claim of fraud under § 523(a)(2)(A). Id. at 948.

110. *In re Ward*, 857 F.2d 1082 (6th Cir. 1988).

111. Id. at 1085. In other words, without a credit check, a card-issuer assumes the risk of non-payment. The simple requirement of a credit check, however, may not prevent the careless distribution of credit cards. See, for example, *In re Briese*, 196 B.R. at 442 (discussing situation in which a credit card company issued a "pre-approved" credit card after conducting a credit check despito the debtors' obligatious equaling nearly two-thirds of their income).

112. Courts are often concerned that creditors do not seek sufficient information when soliciting "pre-approved" credit cards. See, for example, *In re Pressgrove*, 147 B.R. 244, 247 (Bankr. D. Kan. 1992) (noting that creditors must evaluate the debtor's ability to pay and that the information on pre-approved applications, such as name, address, employer, and salary, is insufficient); *In re Leonard*, 158 B.R. 839, 844 (Bankr. D. Colo. 1993) (creditor only requested name, social security number, and tolephone number to grant debtor a $7,500 credit line).

113. See, for example, *In re Carrier*, 181 B.R. 742, 749 (Bankr. S.D.N.Y. 1995) (recognizing the "twofold" inquiry of issuance and monitoring to establish reasonable reliance). See also *In re Foley*, 156 B.R. 645 (Bankr. D. N.D. 1993) (holding reasonable reliance established by history of regular monthly payments).

reliance under the "reasonableness" standard, however, some courts still pay only "lip service" to the reliance element.[114]

In summary, whether due to the inadequacies of the credit card theories or the circuit split regarding the requisite level of reliance, no uniform approach for addressing the reliance element of a card-issuer's fraud claim exists. Furthermore, aside from the handful of cases utilizing the "reasonable reliance" requirement, the majority of cases fail to sufficiently analyze a card-issuer's reliance when extending credit.

3. Current Credit Card Industry Practices Require Inquiry into Reliance

The current practices of the credit card industry demand that courts thoroughly analyze a card-issuer's reliance to determine whether a debtor's fraudulent representation induced the card-issuer to extend credit. After all, a fraud claim requires a plaintiff's reliance upon a representation to be a "substantial factor in bringing about the loss."[115] Several industry practices cast doubt on whether card-issuers routinely meet this requirement when they claim fraud. While these practices will be explained more thoroughly,[116] it is helpful to briefly enunciate them here.

The most obvious industry practice calling a card-issuer's reliance into question is the "pre-approved" credit card. In 1995, "banks mailed out 2.7 billion pre-approved credit-card solicitations, or roughly 17 offers to every American aged 18 to 64 . . . ."[117] The indiscriminate nature in which issuers distribute credit cards should affect their claims of fraud, but no consistent approach has emerged.[118] Besides "pre-approved" solicitations, credit card-issuers also engage in other activities which should lead courts to question the extent of the

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114. See, for example, *In re McDonald*, 177 B.R. 212, 217 (Bankr. E.D. Pa. 1994) ("Reasonable reliance is present if the creditor's actual conduct was consistent with normal business practices in the industry. . . ."). In *McDonald*, a card-issuer was found to have reasonably relied on a debtor's representations of intent to pay for credit despite issuing a "pre-approved" credit card with a $5000 limit to a debtor with a $415 monthly income from welfare and child support. Id. at 214.

115. Restatement (Second) of Torts § 537 cmt. a (1976).

116. See Part IV.B.1.

117. Hays, Wall St. J. at B1 (cited in note 2).

118. See Cowans, 2 Bankr. L. & Prac. § 6.30 (citod in note 92) (noting the problems of the "pre-approved" credit card). But see *In re Sigrist*, 163 B.R. at 949 (noting that "relatively few [cases] have focused upon the legal significance of pre-appreval").

creditor's reliance on a debtor's representations. Some of these other activities include: soliciting card-holders who already own numerous credit cards, setting exorbitant credit limits, requiring only minimum payments for an account to be considered "current," and unilaterally extending a debtor's credit limit.

By failing to require a credit card-issuer to demonstrate a level of reliance above "actual reliance," courts discourage prudent lending through credit cards[119] and have led issuers to believe that a debtor's intent is the exclusive element of a fraud claim.[120] Card-issuers have little incentive to set reasonable credit limits or to issue credit cards carefully as long as they may use the court system to collect from debtors by focusing solely on their conduct. This concern intensifies as the credit card industry lobbies Congress for an objective standard of evaluating a debtor's intent. Such a proposal would codify the current focus of the fraud exception on the debtor.[121]

C. Summary: An Imbalance in the Fraud Exception

Because credit cards play such a major role in our economy,[122] the imbalance in the fraud exception resulting from the credit card theories must be corrected. From a debtor's point of view, the consequences of remaining liable for credit card debt are very significant and can ruin the hope of a "fresh start." Courts should, therefore, ensure that only "dishonest" debtors are punished under the fraud exception. Furthermore, card-issuers should not be "rewarded" with an exception to discharge when they were not "innocent" creditors.[123] Given the problems plaguing courts applying the credit card theories to the fraud exception, courts should initiate their own "fresh start" in analyzing whether credit card debt is non-dischargeable under section 523(a)(2)(A).

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119. See Delinquency on Consumer Loans, Federal News Service (cited in note 4) (testimony of George M. Salem, securities analyst) (criticizing the weak underwriting of credit card lenders).

120. See, for example, *In re Akdogan*, 204 B.R. at 92 ("Plaintiff seems to argue that it is entitled to proceed to trial based solely on the issue of the Debter's intent. . . ."). Despite finding for the debtor, the *Akdogan* court, in denying attorney fees, also stated that the creditor's "position that nondischargeability lawsuits under § 523(a)(2)(A) revolve exclusively upon the Debtor's intent is not without precedent." Id. at 98.

121. See Part IV.

122. See Hansell, The New York Times at 1 (cited in note 13) ("[Consumer credit] now totals nearly $1.2 trillion, of which $350 billion is on credit cards.").

123. Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, *As We Forgive Our Debtors* 189 (Oxford U., 1989) (questioning the "moral implication of rewarding the creditor who was also irresponsible in granting the credit").

IV. THE SOLUTION—THE COMMON LAW OF FRAUD

The common law of fraud requires a creditor to address *each* primary element of a section 523(a)(2)(A) claim, namely intent and reliance.[124] The common law of fraud's subjective analysis of a debtor's intent and its requirement of justifiable reliance also redresses the inadequate analysis other credit card theories have given these two elements. Furthermore, this theory remedies the problem of credit card-issuers gaining preferential status among creditors.

A. Evaluation of the Subjective Intent Standard

In light of the problems of objectively analyzing a debtor's intent, a subjective standard seems preferable. A subjective standard does not provide an inference of fraud from a debtor's insolvency, nor does it prejudice debtors by holding them to a higher standard of care for using a credit card. Instead, a subjective standard focuses on the honesty of the debtor. While difficult for card-issuers to satisfy, a subjective standard does not allow debtors to avoid their credit card debt easily. In addition, because a subjective standard removes the bias favoring issuers, it restores balance to the fraud exception and elevates the importance of establishing justifiable reliance when claiming fraud.

1. Section 523(a)(2)(A) Remains a Viable Exception

When properly articulated,[125] a subjective standard focuses on the honesty of debtors and deters card-issuers from using the fraud exception as an improper collection device.

The Ninth Circuit best described the subjective test of a debtor's intent as a question of whether the debtor "*maliciously and in bad faith*" incurred credit card debt with the intention of petitioning for bankruptcy and avoiding the debt.[126] To find this subjective intent,

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124. See Part II.D (discussing application of the common law of fraud to credit card cases).

125. While seemingly a rhetorical exercise, describing the subjective standard is important because courts often confuse it with an objective standard, and the difference between the two approaches may be outcome determinative. See *In re Murphy*, 190 B.R. at 332 ("Courts have commonly confused these standards."). The *Murphy* court noted that the debtor, a gambler, might have unreasonably relied on his gambling to pay off his debt. Nonetheless, because he honestly believed he would be able to pay, the court granted the discharge. Id. at 334.

126. *In re Anastas*, 94 F.3d at 1286 (emphasis added). In *Anastas*, a debtor financed gambling on credit cards and accumulated over $40,000 in debt. Ironically, the creditor in *Anastas* is

courts may use objective factors as circumstantial evidence, but should not rely on a list of such factors to find bad faith.[127] Without a list of factors, courts can focus on a debtor's "credibility" rather than his reasonableness or financial ability to pay.[128]

Although card-issuers are bound to disagree, the evaluation of a debtor's intent under a subjective standard has intuitive appeal. If a court denies a bankrupt debtor the ability to discharge his or her debt, then the court should find that debtor truly dishonest. Bankruptcy should not be restricted to the reasonable but unfortunate debtor; instead, the honesty of a debtor should be at issue.[129] Reducing the fraud exception to a mechanical formula based on reasonableness eviscerates this principle, especially when the reasonableness of using a credit card is not indicative of the card-holder's intent to pay. Lastly, a subjective standard fosters more careful litigation of credit card cases because issuers are required to produce specific evidence to establish a debtor's fraudulent intent and therefore must investigate debtors before alleging fraud.

2. Dismissing the Idea of an "Escape Hatch" for Debtors

Credit card companies may claim that by requiring proof of a debtor's actual intent to defraud the creditor, courts have created an

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appealing the Ninth Circuit's reversal of the finding that the debt was non-dischargeable because it feels the court based its holding on the debtor's credibility. The lower court did not examine the debtor's intont to pay but instead based its decision on the debtor's ability to pay. The creditor felt the Ninth Circuit's reversal was based on its belief in the debtor's credibility rather than a legal argument because the debtor appealed the case *pro se*. 6 Cousumer Bankr. News (Oct. 21, 1996). However, the legal rule adopted by the Ninth Circuit correctly revolves around the debtor's credibility and honesty.

127. See *In re Murphy*, 190 B.R. at 333-34 (describing how application of a list of factors "clouds" the fact-finding precess). This is not to say that courts using these factors cannot list them and determine the subjective intent of a debtor. See, for example, *In re Eashai*, 87 F.3d at 1091 (utilizing tbe 12 factor approach to establish the debtor's subjective intent). It is significant, though, tbat the Ninth Circuit, in its next opinion, rofused to rely on the 12 factors and, instead, emphasized that the 12 factor test is useful but should never supplant an actual finding of bad faith. *In re Anastas*, 94 F.3d. at 1286. Furthermore, the use of "maliciousness" and "bad faith" signifies a departure from objective criteria. Id. Finally, these terms relate to the opinion of *In re Faulk*, which promulgated the 12 factor test. 69 B.R. at 743. The *Faulk* court noted that fraud involved "moral turpitude or an intentional wrong" and "consist[ed] of any deceit, artifice, trick or design . . . used to circumvent or cheat another. . . ." Id. at 750. Unfortunately, the 12 factors from *Faulk* are cited moro often than this language defining fraud.

128. See, for example, *In re Briese*, 196 B.R. at 453 (discharge granted because debtor/gambler had "an honest, if questionable and undoubtedly foolish, belief that she could win enough to pay her debts").

129. In *In re Alvi*, the court stated: "The issue is the Debtor's subjective intont to repay the debt. Debtors can honestly, but mistakeuly, believe that they have the ability to repay their debts." 191 B.R. at 733.

easy method for debtors to avoid their credit card obligations. This concern is unfounded. A creditor need prove only that a debtor had the requisite fraudulent intent by a preponderance of the evidence.[130] Several creditors have met this standard and successfully proven different debtor's fraudulent intentions.[131]

Perhaps the creditors' real concern regarding a subjective standard is the impropriety of discharging certain types of debt. For example, gambling debts are often dischargeable under the subjective standard.[132] In other words, gamblers often intend to pay for cash advances even when this belief is unreasonable.[133] In these situations card-issuers are not without solutions. First, issuers could propose to amend the Bankruptcy Code to account for gambling debt.[134] Though appealing on its face, this suggestion fails to consider that gamblers who file for bankruptcy do not always do so because of their gambling habits; instead, external events may upset a gambler's precarious financial situation.[135] A better solution would be for card-issuers to perform proper credit checks, establish lower credit lines, and restrict cash advances, thereby reducing the likelihood that gamblers will abuse their credit cards.[136] Card-issuers, however, do not appear too

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130. *Grogan*, 498 U.S. at 287; *In re Murphy*, 190 B.R. at 334.

131. See, for example, *In re Hashemi*, 104 F.3d at 1122 (9th Cir. 1996) (finding fraudulent intent when debtor incurred $60,000 of credit card debt in a six week trip prior to bankruptcy); *In re Eashai*, 87 F.3d at 1082 (finding fraudulent intent in credit card "kiting" scheme); *In re Feld*, 203 B.R. at 371 (finding debtor to be "an unbelievable witness" because of "uncertain [and] incomplete" testimony); *In re Jacobs*, 196 B.R. 429 (Bankr. N.D. Ind. 1996) (finding debtor to have subjective fraudulent intent using evidence deemed admitted from failure to respond to requests for admissions). Of course, one should not expect an overwhelming number of cases finding a debtor's fraudulent intent because, contrary to popular belief, filing for bankruptcy is a serious action for individuals and is not often abused. See Sullivan, Warren, and Westbrook, *As We Forgive Our Debtors* at 329 (cited in note 123) ("A small group, perhaps 5% of all bankrupt debtors, might be abusing the system.").

132. For cases discharging gambling debt on credit cards, see *In re Briese*, 196 B.R. at 440; *In re Murphy*, 190 B.R. at 27; *In re Alvi*, 191 B.R. at 724; *Matter of Totina*, 198 B.R. 673 (Bankr. E.D. La. 1996).

133. See, for example, *In re Murphy*, 190 B.R. at 334 (finding that when "the Debtor incurred the debts at issue he intended te repay them and believed (however unreasonably) that he would have the means to do so. . . .").

134. See *In re Alvi*, 191 B.R. at 733 n.19 ("If Congress intended for all debts incurred in connection with gambling to be found non-dischargeable, it could have done so."). See generally David S. Kennedy and James E. Bailey, *Gambling and the Bankruptcy Code: An Historical Exegesis and Case Survey*, 11 Bankr. Dev. J. 49 (1994-95).

135. See, for example, *In re Alvi*, 191 B.R. at 727-78 (finding gambler's loss of job contributing to bankruptcy).

136. See Ritzer, *Expressing America* at 70 (cited in note 4) (noting the invitation to gambling by not restricting cash advances); *In re Alvi*, 191 B.R. at 728 (noting that the debtor incurred 75% of debt from cash advances at casinos).

concerned with gambling. They provide easy access to cash advances and even permit debtors to purchase playing chips and tokens on credit in casinos.[137]

One last avenue for issuers to pursue in reducing the gambling debt discharged in bankruptcy lies in the presumptions against discharge in section 523(a)(2)(C).[138] Under section 523(a)(2)(C), courts presume that cash advances taken within sixty days of filing for bankruptcy are non-dischargeable.[139] Perhaps courts could extend these time limits. Creditors still need to closely monitor their accounts to take advantage of this presumption. Extending the time limits for presumptions against discharge, though, encourages creditors to pay less attention to their accounts. Once again, a creditor's best solution to avoid the discharge of gambling debt would be to change its own procedures instead of the Bankruptcy Code.

3. New Emphasis on Reliance

Given the difficulties of proving a debtor's intent under a subjective standard,[140] a creditor's reliance enhances his fraud claim under section 523(a)(2)(A). In other words, a card-issuer's fraud claim is most persuasive if the issuer could not have taken any action to prevent its loss. Furthermore, a creditor should be able to produce more evidence of a debtor's subjective intent when that creditor has justifiably relied upon the debtor's representations. Therefore, the subjective standard further balances the interests of debtors and creditors with greater focus on creditors' conduct when determining whether a card-holder committed fraud under section 523(a)(2)(A).

B. Evaluation of the Justifiable Reliance Standard

The justifiable reliance standard of the common law of fraud corrects the deficiencies the alternative credit card theories have in analyzing the conduct of credit card-issuers who invoke section 523(a)(2)(A). Under the justifiable reliance standard, a credit card company must explain why it thought a debtor would make good on its

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137. For example, over the summer of 1996, the New Jersey Control Commission voted to allow credit cards to be used to purchase playing chips and tokens in Atlantic City. Delinquency of Consumer Loans, Federal News Service (cited in note 4) (statements of Rep. LaFalce).

138. See note 25 and accompanying text.

139. 11 U.S.C. § 523(a)(2)(C).

140. These difficulties include the absence of an inference of fraud from a debtor's insolvency and the requirement of finding an actual intent to deceive by the debtor rather than mere unreasonable use of a credit card.

representation of intent to pay for charges incurred and not just demonstrate actual reliance on the debtor's payment to the merchant.

1. Defining Justifiable Reliance in Credit Card Cases

The Supreme Court in *Field v. Mans* identified two attributes of justifiable reliance. First, justifiable reliance is a subjective analysis of a creditor.[141] Second, justifiable reliance requires more than actual reliance[142] as a creditor must "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."[143] As one bankruptcy court has noted, though, "[h]olding that proof of justifiable reliance is required and articulating what that reliance would be in a credit card situation are far different matters."[144]

The most evident feature of cases in which courts have applied the justifiable reliance standard to section 523(a)(2)(A) credit card cases is that a failure to produce any evidence of reliance is fatal to the fraud claim.[145] Additionally, the justifiable reliance standard permits courts to consider the differing circumstances to determine whether the card-issuer was deceived by a debtor's use of a credit card and the ensuing failure to pay for credit extended.[146] These circumstances include, for example, the industry practices of issuing "pre-approved" credit cards, allowing minimum payments to make accounts "current," and unilaterally raising a debtor's credit limit.

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141. Justifiable reliance "is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." *Field*, 116 S. Ct. at 444 (citing Restatement (Second) of Torts § 545A cmt. b) (1976).

142. See Part III.B.2 (explaining actual reliance).

143. *Field*, 116 S. Ct. at 444 (citing Restatement (Second) of Torts § 541 cmt. a (1976)). See also Restatement (Second) of Torts § 537 (1976) (describing justifiable reliance).

144. *In re Feld*, 203 B.R. at 369.

145. See, for example, *In re Christensen*, 193 B.R. 863, 867 (Bankr. N.D. Ill. 1996) ("[B]ecause American Express presented no evidence indicating any reliance on the debtor's representation [of an intent to pay in the future], the bankruptcy court was entirely justified in discharging [the debtor's] credit card debt."); *In re Richards*, 196 B.R. 481, 482 (Bankr. E.D. Ark. 1996) (stating that "the creditor cannot completely ignore its burden with regard to [the justifiable reliance] element of the cause of action").

146. Some courts have held that the use of a credit card is a unilateral contract and, therefore, reliance must be judged upon each use of the card. See, for example, *In re Anastas*, 94 F.3d at 1285 (holding that each credit card transaction forms unilateral contract).

a. Issuance of Credit Cards

As previously mentioned, the most prevalent reliance concern regarding card-issuers claiming fraud is the distribution of "pre-approved" credit cards.[147] By requiring justifiable reliance, courts ensure that issuers may not recover under "fraud" when they distribute credit cards in a careless manner and are not induced into extending credit.

The justifiable reliance standard generally requires no investigation.[148] Superficially, upon issuing a credit card, a card-issuer has no obligations affecting its reliance upon future representations by the card-holder. Justifiable reliance, however, has a common sense requirement. The standard requires a claimant to detect "obvious" errors by using its "senses."[149] The standard thus requires a sophisticated card-issuer to conduct at least a "cursory investigation" of a person's creditworthiness.[150] If this investigation reveals "warning signs" or "red flags," the card-issuer's extension of credit may be unjustified.[151]

Under this level of scrutiny, the court in *In re Briese* held that a card-issuer's reliance was not justified. The creditor had issued a "pre-approved" credit card to a consumer whose debts already exceeded two-thirds of her income.[152] Also, the court in *In re Feld* held that a creditor could not justifiably rely upon a debtor's representations when the creditor issued a credit card with a $7700 credit limit to a debtor whose annual income was only $9000 from

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147. See note 112 and accompanying text (discussing the problem of pre-approved credit cards).

148. Restatement (Second) of Torts § 540 (1976).

149. *Field*, 116 S. Ct. at 444 (quoting Restatement (Second) of Torts § 541 cmt. a) (1976).

150. *In re Feld*, 203 B.R. at 371. Perhaps the best enunciation of the diligence expected of card-issuers was expressed in *In re Alvi*:

> Passively extending credit hardly constitutes reliance on individual instances of card usage, nor can this Court conceive why such reliance, if it did exist, should always be justifiable. A creditor cannot sit back and do nothing and still meet the standard for actual and justifiable reliance when it had an opportunity to make an adequate examination or investigation.

In re Alvi, 191 B.R. at 731.

151. *In re Briese*, 196 B.R. at 454; *In re Anastas*, 94 F.3d at 1286 (citing *In re Eashai*, 87 F.3d at 1091). The Ninth Circuit, though, has not focused upon the issuance of credit cards or the establishment of credit limits to further define this idea. In fact, the *Eashai* court never even addressed how the debtor received a $20,000 credit limit when his income upon receiving the card a couple of years earlier was around $24,000 and he owned 25 other credit cards. *Eashai*, 87 F.3d at 1085.

152. *In re Briese*, 196 B.R. at 454 ("The plaintiff ignored an obvious risk. . . ."). In *Briese*, the debtors received a credit card with a $11,500 credit line while owing $30,000 in unsecured debt and having a combined income of $46,000. Id. at 444. Furthermoro, the debtors had never bad a credit limit above $5000. Id. at 444 n.6.

disability payments.[153] Both courts observed that their decisions resembled results similar to the assumption of risk theory, but they distinguished their holdings by noting that the creditor could not demonstrate justifiable reliance to that particular debtor due to the creditor's own ignorance.[154]

As these cases illustrate, the justifiable reliance standard requires a creditor to issue a credit card carefully and to establish a responsible credit limit before claiming fraud. This level of reliance will help resolve current problems associated with the mass distribution of "pre-approved" credit cards. Card-issuers send mass mailings to preferred customers identified by a multi-factored "credit scoring" system. For example, issuers look for consumers who already have credit cards, a good payment record, or a certain income. The credit scoring systems often quantify the process, essentially removing judgment.[155] Under such conditions, it is questionable whether a debtor's representations are even relevant to the card-issuer's decision to extend credit.[156] Therefore, strict scrutiny of an issuer's reliance is necessary to ensure creditors do not force courts to compensate for the creditors' own lack of initial inquiry regarding potential debtors.

Besides strictly scrutinizing the issuance of credit cards, an analysis of initial credit limits set by card-issuers is also appropriate. First, the computer scoring systems often select consumers who maintain other credit cards.[157] Naturally, enticing a person into receiving another credit card increases the likelihood of that person taking on

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153. *In re Feld*, 203 B.R. at 372.

154. *In re Briese*, 196 B.R. at 454 n.17 ("The creditor is not defeated hecause of the assumption of a blanket risk . . . but because in the particular case the creditor chose to ignore a *known or obvious* risk."); *In re Feld*, 203 B.R. at 370 n.14 ("[D]ischargeability would follow only because the creditor made no cursory investigation. . . .").

155. Ritzer, *Expressing America* at 139-41 (cited in note 4). See *In re Bermingham*, 201 B.R. at 818 (describing credit scoring for pre-approved credit cards); See also *In re Akdogan*, 204 B.R. at 97 (questioning the "evidence" of computer printouts that the creditor offered and noting that without a "meaningful translation or interpretation" they represented "little more than computer gibberish").

156. *In re Briese*, 196 B.R. at 454. One may argue that card-issuers are not even establishing *actual* reliance when issuing "pre-approved" credit cards. See Restatement (Second) of Torts § 537 cmt. a. (1976) ("If the recipient does not in fact rely on the misrepresentation, the fact that he takes some action that would be consistent with his reliance and as a result suffers pecuniary loss, does not impose any liability upon the maker."). See also *In re Alvi*, 191 B.R. at 731 (questioning whether actual reliance can exist absent an investigation).

157. It is shocking to observe the number of cases where debtors have accumulated many credit cards. See, for example, *In re Akdogan*, 204 B.R. at 92 (debtor owned 18 credit cards with a total of over $70,000 in debt); *In re Eashai*, 87 F.3d at 1085-86 (debtor owned 26 credit cards and over $100,000 in debt).

too much debt. Also, card-issuers have increasingly required less information from consumers when soliciting "pre-approved" credit card applications.[158] Additional information could greatly assist card-issuers in establishing responsible credit limits. Failure to obtain such information should be considered intentional disregard of an obvious risk. Lastly, the establishment of credit limits is important to less sophisticated consumers because the limits reflect an experienced financial opinion as to what that person could afford to charge.[159] Thus, when creditors set exorbitant limits, they mislead consumers.

Card-issuers will likely object to this level of scrutiny as second-guessing their decisions to lend. Nevertheless, a successful fraud claim requires a creditor to establish inducement to extend credit. Finding a creditor's reliance unjustifiable, or non-existent, does not prevent issuing "pre-approved" credit cards to consumers, it merely restricts creditors from claiming fraud as a substitute for their failure to evaluate potential debtors ex ante. Considering the sophistication of card-issuers and the resources available to them, this standard is entirely appropriate.[160]

b. Monitoring Accounts and Minimum Payments

Besides justifying the issuance of a credit card, a creditor must also establish that it monitored the account to justify the continued extension of credit.[161] The idea of such a duty, while appealing, is difficult to define. The Ninth Circuit, in *In re Anastas*, interpreted the monitoring duty as simply ensuring, before extending credit, that the

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158. See Delinquency on Consumer Loans, Federal News Service (cited in note 4) (prepared testimony of Ricki Helfer, Chairman, Federal Deposit Insurance Corporation) ("Credit card-issuers primarily rely on credit bureau reports, which typically provide only payment history and outstanding credit."). See, for example, *In re Bermingham*, 201 B.R. at 818 (noting that "creditors cannot obtain a standard credit bureau report without a debtor's consent" and without this information cannot ascertain the total credit available to the debtor or the debtor's current obligations); *In re Akdogan*, 204 B.R. at 92 (noting that creditor issued the credit card without requesting debtor's "expenses, assets, nature of employment or business, health, home ownership, credit references or general financial condition"). See also note 112.

159. See, for example, Singletary and Crenshaw, Sacramento Bee at F1 (cited in note 1) (describing a debtor's belief that "credit card companies would be approving this credit only if they thought he could afford the payments").

Additionally, the establishment of responsible credit lines is important to the entire country. In 1995, available credit lines increased by 30%, creating an "additional potential debt of one point one trillion dollars." Delinquency on Consumer Loans, Federal News Service (cited in note 4) (testimony of Rep. Loach).

160. See generally Ritzer, *Expressing America* at 107-127 (cited in note 4) (describing credit reporting agencies).

161. Judge Ginsberg's analysis in *In re Alvi*, set forth in noto 150, apparently applies to monitoring card accounts as well.

account is not in default.[162] In *In re Willis*, the bankruptcy court in the Western District of Missouri used a more detailed inquiry, noting that an issuer should provide details of *any* facts available to it at the time the debtor used its credit card.[163] As the Northern District of New York Bankruptcy Court observed in *In re Parkhurst*, though, it would be unrealistic for courts to require a credit check with each use of a credit card.[164] Instead, the *Parkhurst* court examined several facts provided by the issuer, such as the history of the credit card's use, the debtor's payments, and the debtor's ability to pay the debt at the time the card was used.[165]

The *Parkhurst* court's consideration of all the evidence ideally defines the justifiable reliance standard for monitoring a credit card account without unduly burdening creditors.[166] Admittedly, scrutiny beyond mere maintenance of minimum payments imposes some additional burdens on card-issuers, but it also may aid them in proving a debtor's subjective intent for a claim of fraud. A closer relationship between the card-holder and the card-issuer could facilitate proving the debtor's intent because the issuer may refer to unique points in a particular account's history rather than comparing it to amorphous "factors."[167] More importantly, the *Parkhurst* approach avoids problems encountered by simply looking at the maintenance of minimum payments to establish justifiable reliance.

The bright line "default" test in *Anastas* may technically satisfy the justifiable reliance requirement, but it invites a mechanical extension of credit and thus contradicts the idea of justifying one's

162. *In re Anastas*, 94 F.3d 1280, 1286 (9th Cir. 1996). See also *In re Samani*, 192 B.R. 877, 880 (Bankr. S.D. Tex. 1996) (finding justifiable reliance on "debtor's prior sporadic payment of at least the minimum monthly amount due").

163. 190 B.R. 866, 870 (Bankr. W.D. Mo. 1996) ("Any creditor which knew of her financial condition in February, 1995, would not have been justified in relying on a representation by debtor that she intended to pay any new credit card debt she was piling up.").

164. 202 B.R. 816, 823 n.10 (Bankr. N.D.N.Y. 1996). Besides the increased transaction time, requesting a credit report with each transaction could detrimentally affect a card-holder's credit rating. Also, credit reports cost about $1.50 a copy and could increase the cost of credit. *Is Reliance Becoming THE Issue*, 4 Consumer Bankr. News (cited in note 11).

165. *In re Parkhurst*, 202 B.R. at 819.

166. If card-issuers obtained credit reports monthly, the cost of credit would increase by an estimated one percentage point. *Is Reliance Becoming THE Issue*, 4 Consumer Bankr. News (cited in note 11). Card-issuers might reduce some of their losses from bankruptcy by obtaining more credit reports; therefore, this estimation may be overstated. Furthermore, a monthly credit check may not be necessary, especially when creditors have two months "protection" under § 523(a)(2)(C).

167. See, for example, *In re Wong*, 207 B.R. at 822 (holding credit card debt non-dischargeable when creditor justified reliance on debtor's account history and proved subjective intent).

reliance. After all, if a debtor is only making minimum payments, the debt will not be paid off for quite some time.[168] At some point, it becomes impossible to justify continued extension of credit with the expectation of repayment. In fact, a recent trend of card-holders filing for bankruptcy without warning of default has developed.[169] Also, while a debtor's payments establish a presumption that indicates a lack of fraudulent intent, the practice of credit card "kiting" demonstrates that this requirement can be manipulated and should not be the "end all" inquiry.[170]

c. Raising Credit Limits

One final situation calling into question the issue of reliance involves the creditor's increase of a debtor's credit limit. Courts are split on whether a card-issuer can justify its reliance upon charges over a credit limit it unilaterally increased.

The Bankruptcy Appellate Panel for the Ninth Circuit held in *In re Burdge* that a card-issuer may unilaterally increase a debtor's credit limit without investigating and may still claim justifiable reliance upon a debtor's intent to pay for charges up to the new limit.[171] In *Burdge*, the debtor received a credit card with a $3000 limit that was subsequently increased to $4000. Three years later, as part of a promotion, the issuer increased the debtor's credit limit to $8000.[172] Despite finding that the debtor engaged in a spending spree prior to bankruptcy, the bankruptcy court refused to except any debt over the original $4000 credit limit because the card-issuer had

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168. See note 65. Also, legitimate arguments may be made regarding the reliance on mere minimum payments. See *In re Briese*, 196 B.R. at 445 n.6 (noting debtor's argument that a creditor's reliance upon minimum payments served to "perpetuate the existence of larger balances subject to inflated interest rates"). This is not to say that minimum payments should not be used to justify reliance. Indeed, courts have used minimum payments to establish reasonable reliance. See *In re Foley*, 156 B.R. at 645 (finding reasonable reliance established by history of minimum payments). Looking *only* at minimum payments may be questionable, however.

169. Michelle Singletary, *A New Breed of Debtor Shocks Credit Card-issuers*, The Washington Post F01 (Sept. 18, 1996). Presumably, payments by a debtor indicate an intent to repay the debt. Therefore, allowing minimum payments to establish reliance may be fair, but courts should take caution so that creditors do not blindly extend credit. Since more people who have had a "meaningful credit card relationship for more than seven years" are now filing bankruptcy, the monitoring of card accounts seems very important to ensure that those customers do not develop a fraudulent intent to incur debt before filing. Id.

170. See *In re Eashai*, 87 F.3d at 1088-89 (describing credit card kiting and revealing that making of minimum payments does not always manifest an intent to repay the entire debt).

171. *In re Burdge*, 198 B.R. 773, 778 (9th Cir. B.A.P. 1996).

172. The card-issuer claimed that this raise was also due to the debter's "satisfactory payment history" but provided no evidence of this in court. Id.

increased the debtor's credit limit to $8000 at a time when the debtor had already exceeded his $4000 credit limit by more than $1500. The Bankruptcy Appellate Panel reversed in part citing *Field v. Mans* and declared the entire debt non-dischargeable.[173]

The court in *In re McDaniel* held differently in a similar situation.[174] In *McDaniel*, the debtor received a credit card with a $3000 limit. Under a low interest rate promotional campaign, the card-issuer provided the debtor an "Access Check" to "consolidate other credit card balances or to buy a holiday gift" and increased the debtor's credit limit to $5400. This increase came without a credit check and when the debtor was "financially strapped." The court held that the creditor's unilateral increase of the debtor's credit limit was a representation of the creditor, not the debtor, and that the card-issuer failed to explain its reliance on debt incurred over the original credit limit.[175]

The *McDaniel* decision represents the more sensible approach for applying the justifiable reliance standard when creditors increase a debtor's credit line. Automated promotional campaigns to raise credit limits, in essence, are no different than those generated to issue credit cards. If card-issuers may freely raise credit limits, they may circumvent any precautionary measures established for issuing a credit card. In other words, credit cards may be solicited with responsible credit limits only to have them raised carelessly by issuers. A requirement of justifiable reliance upon raising credit limits, though, encourages lower overall credit limits.[176] Furthermore, for debtors who hold credit cards for a couple of years, issuers should check before raising limits to ensure that the debtor's financial situation remains stable.[177] Finally, requiring debtors to request credit increases pro-

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173. Id. at 778-79.

174. 202 B.R. 74 (Bankr. N.D. Tex. 1996).

175. Id. at 79. The court also concluded that to allow the Bank to prevail in this situation would amount to condoning commercial entrapment. Id. See also *In re Chinchilla*, 202 B.R. at 1010 (rejecting card-issuer's claim of fraud when debtor exceeded its credit limit of $6500 and card-issuer responded by raising the debtor's credit limit to $8500).

176. Currently, this country has over $1.2 trillion worth of unused lines of credit. Delinquency on Consumer Loans, Federal News Service (cited in note 4) (prepared testimony of Ricki Helfer, Chairman, Federal Deposit Insurance Corporation). This "high level" of unused credit poses a risk to institutions as consumers become more overextended. Because of such a high level of unused credit, monitoring should be encouraged when card-issuers decide to raise credit limits.

177. Sullivan, Warren, and Westbrook, *As We Forgive Our Debtors* at 188 (cited in note 123) (citing a study of "credit card junkies" that revealed a large number of debtors who had "serious income interruptions" prior to bankruptcy). Discovery of a change in a debtor's financial

vides better evidence of fraud, that is a direct representation to the issuer, should that debtor file bankruptcy thereafter.

2. Are Courts Requiring "Reasonable" Reliance?

Recent credit card cases present a question regarding the application of the justifiable reliance standard: Do courts really require *reasonable* reliance of card-issuers? After all, decisions such as *In re Briese* and *In re Feld* resemble *In re Ward* in which the Sixth Circuit required a credit card-issuer to perform a credit check to establish reasonable reliance.[178] Likewise, the reliance required for monitoring and credit increases seems substantial. While it is unclear whether courts are requiring issuers to demonstrate "reasonable" reliance, this is not cause for concern.

It is a popular misconception that justifiable reliance presents a lower threshold than reasonable reliance.[179] Rather, the subjectivity of the standard demands a high level of justification from sophisticated creditors, like credit card-issuers. In fact, the Supreme Court stated that the "justifiable" standard may hold such a plaintiff to a high standard of reliance: "Naifs may recover, at common law and in bankruptcy, but lots of creditors are not at all naive. The subjectiveness of justifiability cuts both ways. . . ."[180] Therefore, credit card companies should be held to a high level of justification which essentially forces them to prove "reasonable" reliance at times.[181] Continued concern over this semantic point detracts from the important fact that, in the credit card context, both standards require an explanation from a card-issuer as to why the issuer believed a debtor would pay for the credit extended.

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situation would alert card-issuers of possible fraud before it happens or, perhaps, prevent a claim of fraud based upon an objective look at the account.

178. See Part III.B.2.

179. See, for example, Middleton and Daly, 9 Credit Card Mgt. at 108 (cited in note 11) (noting that "justifiable reliance is a less exacting standard" and citing attorneys who believe that justifiable reliance standard is easier for creditors to prove).

180. *Field*, 116 S. Ct. at 446.

181. This fact applies to non-credit card cases as well. See *In re Kirsh*, 973 F.2d 1454 (9th Cir. 1992). In this non-credit card case, the *Kirsh* court recognized that a lender with knowledge, experience, and competence should have ordered a title report before relying upon a close friend's representations about certain real estate. Id. at 1460. The court emphasized the "subjective effect" on the creditor in the situation that justifiable reliance requires. Id.

V. JUDICIAL AND LEGISLATIVE SUGGESTIONS

A. Universal Adoption of the Common Law of Fraud in Credit Card Cases

Courts should explicitly reject previous credit card theories and uniformly adopt the common law of fraud for credit card cases under the fraud exception.[182] The credit card theories detract from the essential focus of the fraud exception: the analysis of a debtor's intent *and* a creditor's reliance. Addressing both elements equally creates a balance of interests between the "fresh start" and the fraud exception. It is essential to pay equal attention to both intent and reliance due to both the deceptive practices of card-issuers which may obscure a debtor's intent when using a credit card and to the industry's careless distribution of credit cards.

Once courts adopt the common law of fraud to analyze credit card non-dischargeability actions, they should establish justifiable reliance as a threshold inquiry and dispose of meritless claims more effectively. Instead of painstakingly establishing that a debtor lacked the requisite fraudulent intent, courts could decide more credit card cases on grounds of lack of reliance. Deciding cases on a lack of reliance would send a clear signal to credit card companies that claiming the fraud exception is not a guaranteed means of obtaining payment. On the other hand, disposing of cases for failure to establish that a debtor intended to defraud the card-issuer, without addressing the issuer's reliance, does not encourage companies to reform their lending procedures. Although courts may not find reliance dispositive in many cases, the current practices of the credit card industry demand that courts first examine whether a creditor justifiably relied upon the debtor's intent to pay when it extended credit to that debtor.

In re Alvi is an instructive example of the outcome of a fraud claim when a court properly investigates justifiable reliance.[183] In *Alvi*, the debtor filed bankruptcy due to the "economic woes" brought

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182. Uniformity is needed on this issue because a general concern of disparity in the bankruptcy system exists. See Delinquency on Consumer Loans, Federal News Service (cited in note 4) (Prepared Testimony of Brady C. Williamson, Chair, National Bankruptcy Review Commission) ("When the system is subject to so many variable facts, it invites litigation, it invites injustice through disparate treatment, and it invites abuse."). The problems in § 523(a)(2)(A) credit card cases clearly exemplify this concern.

183. *In re Alvi*, 191 B.R. at 724.

on by the combination of his gambling habit and being laid off from his job.[184] The creditor alleged fraud because the debtor had exceeded his $7,500 credit limit prior to filing bankruptcy. The court questioned the creditor's justifiable reliance and found the evidence of reliance woefully inadequate.[185] Only after the court examined the creditor's reliance interest did it support its decision by holding that the creditor had also failed to establish the remaining elements of fraud.[186]

The court's approach in *Alvi* is appealing because it counters decisions that suggest that only dishonest debtors take advantage of the bankruptcy system.[187] When card-issuers cannot establish justifiable reliance, they have essentially acted as accomplices to allegedly deceptive card-holders, as both parties defraud the public. Because the issuers are in the best position to correct this behavior, they should prove their own lack of liability first by establishing justifiable reliance at the outset.[188] Only after creditors establish their justifiable reliance can courts determine that the debtor is the party attempting to take advantage of the bankruptcy system.[189]

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184. Id. at 727-28.

185. Id. at 729-32.

186. Id. at 731.

187. See, for example, *In re Willis*, 190 B.R. at 866 (finding debtor to have fraudulent intent under objective factor test, but issuer denied exception because of lack of reliance); *In re Feld*, 203 B.R. at 371-72 (finding debtor to have fraudulent intent under subjective test, but denying exception because of a lack of card-issuer's reliance).

188. See Filipow, 57 Ind. L. J. at 331 (cited in note 3) (describing how credit card-issuers are in "the best position to devise and initiate safeguards against credit card abuse").

189. In addition to treating reliance as a threshold inquiry, judges should consider using § 523(d) more often to impose attorneys' fees against credit card-issuers who bring meritless fraud claims. As already noted, card-issuers have a considerable amount of leverage and incentive to bring fraud claims without prior investigation. Awarding attorney fees more often could supplement the use of the common law of fraud and curtail card-issuers' abuse of the fraud exception without foreclosing legitimate fraud claims. As the court in *In re Chinchilla* stated:

> This Court is not closing the 523(a)(2)(A) 'town gates' to credit card issuers. Just don't ride into town firing blanks and kicking up dust in the hope of rustling up a settlement. Come in armed with facts to prove fraud or you may be driven out of town with a 523(d) bullet in your tail.

202 B.R. at 1018.

Section 523(d) provides that "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 fees for, the proceeding if the court finds that the position of the creditor was not *substantially justified*." 11 U.S.C. § 523(d) (emphasis added). The "substantially justified" language, which reduced the likelihood of awarding a debtor attorney fees, was added to this provision in 1984, the same time the "load up" provision was added to § 523(a)(2)(C). Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 354 (1984). Both provisions favor credit card-issuers. If the courts recognized the unjustified fraud claims more often, though, perhaps more careful lending and litigation would ensue.

B. Rejection of the Objective Intent Proposal

In light of the preceding analysis, the consumer credit industry's proposal to codify an objective intent requirement for section 523(a)(2)(A) is ill-founded. Courts are already beginning to draw upon the common law of fraud to analyze a debtor's intent under a subjective standard.[190] The subjective intent standard, in conjunction with the justifiable reliance requirement, deters credit card companies from using the fraud exception as a collection device in lieu of taking precautions regarding the maintenance of credit card accounts. Codifying an objective intent standard, on the other hand, exposes the fraud exception to abuse by credit card-issuers. Also, an objective standard is not likely to alter a debtors' behavior because probably few debtors are aware of the existence of this Bankruptcy Code provision.

Most importantly, the irony behind the credit card industry's proposal of an objective intent standard reveals the proposal's shortcomings. If a card-issuer can establish that a debtor incurred certain debt without the reasonable ability to repay, that creditor would struggle to explain how it extended credit with the justifiable expectation of getting repaid. Apparently, though, the credit card industry is attempting to change the Bankruptcy Code instead of the individual policies and practices of card-issuers.[191]

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190. See, for example, *In re Briese*, 196 B.R. at 440; *In re Murphy*, 190 B.R. at 327.

191. If the fraud exception of the Bankruptcy Code should be amended at all, § 523(a)(2)(A) should explicitly require a "reasonable" reliance standard for credit card-issuers. While the justifiable reliance standard adequately addresses many reliance concerns relating to credit card-issuers, ample room exists for confusion in its application. Credit card-issuers may not understand that in certain circumstances they are essentially required to demonstrate reasonable reliance on a debtor's representations. Codifying a reasonable reliance standard, however, would serve notice of this fact to credit card-issuers. Furthermore, an explicit "reasonable" reliance standard may encourage more diligent investigation of fraud claims and help curb the careless distribution of credit cards.

Interestingly enough, the Supreme Court, in holding that § 523(a)(2)(A) required justifiable reliance, questioned why a different rule of "reasonable" reliance applies when "fraud is carried to the point of a written statement." *Field*, 116 S. Ct. at 437. As indicated by the legislative history, Congress inserted the "reasonable" reliance requirement in § 523(a)(2)(B) out of concern for certain creditor manipulation of debters. More specifically, Congress noted that consumer finance companies sometimes encourage falsity in writing so that they could insulate their own debts from discharge.

Congress's concern reflects the behavior of today's credit card-issuers who encourage debt-spending and then cry "fraud" when card-holders file bankruptcy. Therefore, perhaps it is time to amend the Code with a "reasonable" reliance requirement for card-issuers. Of course, to ensure proper attention to any codification of such a reliance standard, courts must first dismiss previous "credit card theories" and begin applying the common law of fraud to § 523(a)(2)(A) credit card cases.

VI. CONCLUSION

Courts need to adopt the common law of fraud to resolve problems resulting from the application of the credit card theories to section 523(a)(2)(A) claims. Applying the common law of fraud correctly identifies the parties responsible for society's credit card problems as *both* consumers and credit card companies by focusing upon the elements of intent *and* reliance in section 523(a)(2)(A) claims. By requiring issuers to prove a debtor's subjective fraudulent intent, the fraud exception, as applied to credit card debt, will focus on denying discharge to dishonest debtors without opening the door for debtors to commit fraud. More importantly, the common law of fraud requires issuers to show justifiable reliance, and therefore addresses previously neglected reliance problems created by current credit industry practices.

Overall, the common law of fraud ensures that fraud claims under section 523(a)(2)(A) are not abused by frustrated creditors that unwisely extended credit to a debtor. The application of the common law of fraud to section 523(a)(2)(A) credit card cases preserves the inherent balance of interests between the fraud exception and the "fresh start" policy by ensuring that only innocent creditors receive exceptions for the debts of dishonest debtors.

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