GAMBLING ON DISCHARGEABILITY

Alexander L. Edgar, Assistant U.S. Trustee
Northern District of Indiana
and
Ellen L. Triebold, Attorney for the U.S. Trustee
South Bend, Indiana[1]

Introduction

With the increasing popularity of river boats, state-sanctioned lotteries and land-based casinos, the issue of the dischargeability of gambling debt is gaining importance. One research group suggests that about 10 percent of bankruptcy filings are linked to gambling losses, 20 percent or more of compulsive gamblers are forced to file bankruptcy because of their losses, and upwards of 90 percent of compulsive gamblers use their credit cards to gamble.[2] Harvard Medical School researchers estimate that around 1.3 percent of American adults have a gambling disorder.[3] These figures are significant considering that in 1997 over 1.3 million consumer bankruptcy cases were filed. Congress has even created a commission to study the social and economic consequences of legalized gambling.[4]

Not so long ago, bankruptcy courts regularly found gambling debt nondischargeable. More recently, however, and perhaps as a repercussion of the upsurge in legalized gambling in many states, the courts are allowing discharge of this

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[1] All views expressed in this article are those of the authors and do not necessarily represent the views of, and should not be attributed to, the U.S. Department of Justice or the Office of the United States Trustee.

[2] SMR Research Corporation, *The Personal Bankruptcy Crisis, 1997*, at 14, 18.

[3] *Harvard Medical School Researchers Map Prevalence of Gambling Disorders in North America,* <http://www.hms.harvard.edu/about/releases/1297gambling.html> (Dec. 4, 1997).

[4] Gambling Impact Study Commission Act, Pub. L. No. 104-169, 110 Stat. 1482 (1996), as amended by Pub. L. No. 105-30, 111 Stat. 248 (1997).

debt. Nonetheless, the nation's current climate of bankruptcy reform, coupled with the increased frequency of gambling debt, portends an uncertain future for the dischargeability of such debt. Legislatures' apparent schizophrenia—-legalizing more gambling, yet condemning the ever-increasing amount of consumer debt and the "ease" of its discharge—-adds to the confusion. This article summarizes the current state of the law and forewarns of some proposed changes to the law.[5]

Legalized gambling debt may be incurred when credit is extended by riverboats and casinos directly to patrons. More commonly, gambling debt may manifest itself as cash advances from credit cards. Debtors seek to discharge this gambling debt under 11 U.S.C. 727. Creditors, in turn, seek its nondischargeability, typically under § 523(a)(2)(A), which excepts from discharge a debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition ... ." Fraud in this context means common law fraud: creditors must rely to their detriment on a material misrepresentation that was intentionally made. *See Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). Creditors must prove each element of the fraud by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991).

With credit card debt, proving a debtor's misrepresentation and a creditor's reliance thereon is difficult because of the lack of personal contact between the parties. Courts have responded to this problem in different ways. Some bankruptcy courts have adopted an "implied representation" theory, under which the use of a credit card is an implied representation to the issuer of the holder's intent and/or ability to pay. *See GM Card v. Cox,* 182 B.R. 626, 633 (Bankr. D. Mass. 1995) (collecting cases yet rejecting theory). Other courts have adopted an "assumption of the risk" theory, which provides for the discharge of credit

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[5] *See also* James M. Cain, *Proving Fraud in Credit Card Dischargeability Actions: A Permanent State of Flux?* 102 Com. L. J. 233 (1997); *Reforming Consumer Bankruptcy Law: Four Proposals*, 71 Am. Bankr. L. J. (1997); Hon. David S. Kennedy & James E. Bailey, *Gambling and the Bankruptcy Discharge: An Historical Exegesis and Case Survey*, 11 Bankr. Dev. J. 49 (1995).

card debt incurred before the issuer communicates to the holder that it is revoking the card. *First National Bank of Mobile v. Roddenberry*, 701 F.2d 927, 932 (11th Cir. 1983) (Bankruptcy Act case). Still other courts have adopted a "totality of the circumstances" test, sometimes in conjunction with an implied representation theory. *See Household Credit Services, Inc. v. Jacobs*, 196 B.R. 429, 433 (Bankr. N.D. Ind. 1996).

Case Law

Despite the theory articulated, earlier cases often found gambling debt nondischargeable by appearing to examine a debtor's intent to repay objectively. This approach was no different than that used in cases involving non-gambling credit card debt, despite the unique factor that cash advances for gambling could produce revenue, rather than just pay for goods and services. In *Chemical Bank v. Clagg*, 150 B.R. 697 (Bankr. C.D. Ill. 1993), the debtor, a long-time gambler, admitted that his only hope of repaying his debt was winning the lottery. The court found that "[m]ere hope, or unrealistic or speculative sources of income, are insufficient" to show an intent to repay. *Id.* at 698; *see also American Express v. Nahas*, 181 B.R. 930 (Bank. S.D. Ind. 1994) (debtor's hope to repay debts from gambling winnings did not provide requisite reasonable expectation or intent to repay); *Citibank v. Hansbury,* 128 B.R. 320 (Bankr. D. Mass. 1991) (debtor's hope of repaying debt by winning big at gambling "unrealistic"); *FCC National Bank v. Bartlett*, 128 B.R. 775 (Bankr. W.D. Mo. 1991) (debtor's belief that she could repay her debt through gambling not "reasonable"); *contra First Federal of Jacksonville v. Landen*, 95 B.R. 826, 829 (Bankr. M.D. Fla. 1989) (debtor's "honest but somewhat questionable belief that he would soon get lucky at gambling and pay off his debts" demonstrated intent to repay).

Even when the court sympathized with the debtor's circumstances as it did in *Karelin v. Bank of America Nat'l Trust & Sav. Assoc.,* 109 B.R. 943, 947-48 (9th Cir. B.A.P. 1990), the debtor's "hopeless financial condition" when she obtained cash advances and the "consistently unsuccessful results of her more than fifteen years' gambling experience" convinced the court that she had no ability and no intent to repay her debts. The court so ruled despite the debtor's history of repaying some debt and belief in her future ability to do so. Although the court noted that the debtor was as much victim as culprit, in that her gambling addition was "in

large part a function of the credit and facilities made available to her by the casinos," it found that "[t]he Bank was not a gambling partner of the defendant but simply a lender." *Id.* at 949.

In recent years, this country's policies toward gambling have shifted. As stated by one court:

> At one point in time, not so far in the past, gambling was against public policy and gambling debts were not enforceable in a court of law. But public policy changed. Certain forms of gambling are now legal ... . They are hyped as a source of jobs (i.e. Riverboat gambling), as a source of revenue for government (i.e. Lotto proceeds used for education) and as a form of entertainment (i.e. Riverboat and off-track betting).

Clagg, 150 B.R. at 698. Mirroring this public policy shift are bankruptcy courts' apparent shift toward finding gambling dischargeable. Many recent courts reach this result by measuring a debtor's intent to repay subjectively rather than objectively.

For example, in *AT&T Universal Card Services v. Alvi*, 191 B.R. 724, 734 (Bankr. N.D. Ill. 1996), the debtor, a regular gambler who used his winnings to supplement his modest $12,000 income, incurred debt of approximately $54,202.19, mostly as cash advances at casinos. Even though the amount of credit card debt in relation to income appeared excessive, the court found that, based on his history, the debtor genuinely believed he would be able to pay his debts and had the intent to pay his credit card debts at the time he incurred them. *See also Anastas v. American Savings Bank,* 94 F.3d 1280 (9th Cir. 1996) (debtor-gambler had intent to repay his debt); *Chase Manhattan Bank v. Murphy*, 190 B.R. 327 (Bankr. N.D. Ill. 1995) (finding for the debtor, a gambler who had successfully supplemented his regular income for years with his gambling winnings, and who believed that he could continue to do so in the future); *but see Jacobs*, 196 B.R. at 434 (even under subjective test, debtors "knew or should have known that they could not possibly pay" credit card debt).

In another recent case, *AT&T Universal Card Services v. Crutcher*, 215 B.R. 696 (Bankr. W.D. Tenn. 1997), the debtor suffered from a severe, diagnosed, gambling addiction

resulting in an $11,885.75 cash-advance balance on her credit card. Eleven months after her latest gambling spree, the debtor filed bankruptcy. The court, using a subjective approach, "including the reality of the debtor's addiction," focused on the intent of the debtor to repay her debts and found the credit card debt dischargeable. The debtor's good faith belief that she could repay her debts and her history of doing so supported the discharge of the debt.

In addition to a debtor's subjective intent to repay, some recent decisions focus on whether a card issuer's reliance on the debtor's representations were justifiable. *See, e.g. Alvi*, 191 B.R. at 729. A creditor's reliance is justifiable if the falsity of the representation is not obvious to someone having the creditor's knowledge and intelligence, even if an investigation would have disclosed the falsehood. *See Field*, 516 U.S. at 44.

In *FCC National Bank v. Cacciatore*, 209 B.R. 609 (Bankr. E.D.N.Y. 1997), the card issuer performed a credit check on the debtor before sending him an "invitation" for credit. The debtor indicated on the invitation that he was a student and left blank the space for a business phone number. The issuer then performed a second credit check, but apparently did not determine whether the debtor was employed or had financial resources. In less than a month, the debtor received 12 cash advances for gambling. Finding for the debtor, the court concluded that, even assuming that the debtor did not intend to repay his gambling debt, the issuer did not justifiably rely on that representation, based on the issuer's failure to make relevant inquiries about the debtor's disclosures on the "invitation." *Id.* at 617.

Depending on the facts of the case, gambling debt may also be found nondischargeable under other subsections of § 523(a)(2). At least one court has found gambling debt incurred on the eve of bankruptcy nondischargeable as "luxury goods or services" under § 523(a)(2)(C). *Trump Plaza Assoc. v. Poskanzer*, 143 B.R. 991 (Bankr. D. N.J. 1992). In addition, if there is a written statement, such as credit markers signed by a patron of a casino, the debt may be nondischargeable under § 523(a)(2)(B). *Id.* at 1000.

Proposed Legislation

As noted by one court, "[t]hat gambling debt should be

dischargeable in bankruptcy provokes strong reactions. However this court may feel about the morality of the Bankruptcy Code permitting discharge of such debt, there is no statutory rule that the use of credit cards to incur gambling debts shows the requisite intent of a debtor not to pay his debts. ... If Congress intended that credit card advances for gambling losses be treated in any different fashion than any other debts incurred by an honest—-albeit, misinformed, and always overly optimistic—-debtor, it can always amend the Bankruptcy Code." *AT&T Universal Card Services Corp. v. Totina,* 198 B.R. 673, 681 (Bankr. E.D. La. 1996).

In fact, Congress has at least three major consumer bankruptcy reform bills pending which would, if passed, undoubtedly have a direct or indirect impact on the treatment of gambling debt. On February 3, 1998, Rep. George Gekas (R-Pa) introduced the "Bankruptcy Reform Act of 1998" (H.R. 3150), which provides, *inter alia*, for a needs-based bankruptcy system and an amendment to § 523(a)(2)(C) to create a presumption that consumer debts incurred within 90 days of bankruptcy are nondischargeable. The bill also provides that debt incurred when the debtor had no reasonable expectation or ability to repay are nondischargeable.[6]

Rep. Jerrold Nadler (D-NY) has introduced the "Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998" (H.R. 3146), which would, *inter alia*, amend § 502(b) to disallow claims that "arise from a debt incurred in or adjacent to a gambling facility or a debt that the creditor knew or should have known was intended to be used for gambling."[7]

On the Senate side, Sens. Charles Grassley (R-Iowa) and Richard Durbin (D-Ill) have co-sponsored a bill (S. 1301) that allows creditors to file § 707(b) "substantial abuse" motions and authorizes a form of "means-testing" for Chapter 7 eligibility.

The National Bankruptcy Review Commission recommended in its report, issued October 20, 1997, that credit card debts

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[6] *Legislative Update*, Am. Bankr. Inst. J., March 1998, at 6.

[7] *Legislative Update*, Am. Bankr. Inst. J., March 1998, at 41.

incurred less than 30 days before filing be nondischargeable. Debts incurred more than 30 days before filing would be dischargeable unless the amount of the charge exceeded the debtor's credit limit.[8]

Conclusion

In light of the current climate of reform and the increases in consumer debt and in legalized gambling, the future of the dischargeability of gambling debt is unclear. Nonetheless, whatever changes in the dischargeability of credit card and gambling debt Congress ultimately adopts, the competing policies of preserving a debtor's "fresh start" but not providing the debtor a "head start" must be carefully balanced.

[8] Gary Klein, *Consumer Bankruptcy In the Balance: The National Bankruptcy Review Commission's Recommendations Tilt Toward Creditors*, 5 Am. Bankr. Inst. L. Rev. 293, 314-319 (1997).