

1 **WRITTEN DECISION NOT FOR PUBLICATION**

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ENTERED **MAR 26 2007**
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CLERK, U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
BY _____ DEPUTY

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

11 In re) Case No. 05-09757-B7
12) Adv. No. 05-90521-B7
13 BARRON ANTHONY GONZALES and)
14 LISA GONZALES,)
15) MEMORANDUM DECISION
16 Debtors.)
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26)
BANKCARD CENTRAL, INC.,)
Plaintiff,)
v.)
BARRON ANTHONY GONZALES,)
Defendant.)

22 This adversary proceeding came on regularly for trial on
23 plaintiff's complaint seeking a judgment that the debt owed to it
24 by debtor Gonzales is nondischargeable pursuant to 11 U.S.C.

25 § 523(a)(2)(A).

26 ///

1 This Court has subject matter jurisdiction pursuant to
2 28 U.S.C. § 1334 and General Order No. 312-D of the United States
3 District Court for the Southern District of California. This is
4 a core proceeding under 28 U.S.C. § 157(b)(2)(I).

5 Section 523(a)(2)(A) of Title 11, United States Code,
6 provides:

7 (a) A discharge under section 727, 1141,
8 1228(a), 1228(b), or 1328(b) of this title does
9 not discharge an individual debtor from any debt -

10 (2) For money, property, services, or an
11 extension, renewal or refinancing of credit,
12 to the extent obtained by --

13 (A) False pretenses, a false
14 representation, or actual fraud, other than a
15 statement respecting the debtor's or an
16 insider's financial condition . . .

17 The Bankruptcy Code has long prohibited debtors from
18 discharging liabilities incurred on account of their fraud,
19 embodying the basic policy animating the Code of affording relief
20 only to the "honest but unfortunate debtor." Cohen v de la Cruz,
21 523 U.S. 213, 217 (1998).

22 The provision of the Bankruptcy Code which excepts from
23 discharge debts arising from fraud is § 523(a)(2)(A). In
24 applying § 523(a)(2)(A), courts in the Ninth Circuit employ a
25 five-part test:

- 26 (1) that the debtor made . . . representations;
(2) that the debtor knew the representations were
false when made;
(3) that the debtor made the representations with
the intention and purpose of deceiving the
creditor;
(4) that the creditor relied on such
representations; and

1 (5) that the creditor sustained the alleged loss
2 and damage as the proximate result of the
misrepresentations having been made.

3 In re Hashemi, 104 F.3d 1122, 1125 (9th Cir. 1997); In re Apte,
4 96 F.3d 1319, 1322 (9th Cir. 1996). In order to prevail on a
5 claim asserted under § 523(a)(2)(A), a creditor must establish
6 each of the five elements by a preponderance of the evidence.

7
8 1. Representation

9 The first element, or part, of a cause of action under
10 § 523(a)(2)(A) is that the debtor made one or more
11 representations. The statute itself makes clear that any
12 representation must be "other than a statement respecting the
13 debtor's or an insider's financial condition". Representations
14 as to such financial condition are actionable, if at all,
15 only under 11 U.S.C. § 523(a)(2)(B), and then only if the
16 representations are in writing. In re Barrack, 217 B.R. 598,
17 605 (9th Cir. BAP 1998); In re Tallant, 207 B.R. 923, 931 (Bankr.
18 E.D. Cal. 1997).

19 Can the representation be about anything, or are there
20 limits on what representations may be actionable under
21 § 523(a)(2)(A)? As the Supreme Court recognized in Field v.
22 Mans, 516 U.S. 59, 70 (1995), it must be a "representation of
23 fact". The Ninth Circuit has recognized the same, and used to
24 include the phrase "representation of fact" in stating the
25 elements of a cause of action under § 523(a)(2)(A). In re Rubin,

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1 875 F.2d 755, 759 (1989); In re Gertsch, 237 B.R. 160, 167
2 (9th Cir. BAP 1999).

3 Other courts have elaborated. In In re Schwartz & Meyers,
4 130 B.R. 416, 423 (Bankr. S.D.N.Y. 1991), the court stated:

5 To be actionable, the representation must be
6 one of existing fact and not merely an
7 expression of opinion, expectation or
8 declaration of intention. [Citations
9 omitted.] Also falling within the purview of
nonactionable language are those statements
which amount to no more than sales "puffery"
upon which reliance should not be placed.

10 Similarly, in In re Spar, 176 B.R. 321, 327 (Bankr. S.D.N.Y.
11 1994), the court wrote:

12 In order for Spar's representations to be a
13 false representation or false pretense under
Code § 523(a)(2)(A), the representations must
14 "encompass statements that falsely purport to
depict current or past facts. [Citation
15 omitted.] A promise to perform in the future
is insufficient. . . . Representations as to
16 opinion, expectation or declarations of
intention do not relate to existing fact and
17 are not actionable.

18 See, also, Greenberg v. Chrust, 2002 WL 31444902 (S.D.N.Y. 2002).

19 In In re Evans, 181 B.R. 508, 512 (Bankr. S.D. Cal. 1995),
20 that court stated:

21 To support a § 523(a)(2)(A) action, the
22 creditor must establish that the debtor made
a false representation with respect to an
23 existing and ascertainable fact. [Citation
omitted.] A representation of value generally
24 is merely a statement of opinion and, as
such, it "does not support a fraud claim
25 either under common law or under the
Bankruptcy Code."

26 ///

1 Despite the clear requirement that the representation be of
2 an existing or past fact, some courts have evaded the element.
3 In Evans, after stating what is quoted above, the court added:
4 "However 'this rule presupposes that such a representation does
5 in fact represent the declarant's opinion.'" It is not at all
6 clear why an opinion of value, which is not actionable because it
7 is not a representation of an existing fact, somehow becomes
8 actionable if the declarant doesn't believe in its truth.
9 Nevertheless, as the Evans court wrote:

10 When the debtor represented that the
11 lot had a value in excess of the existing
12 \$65,000 deed of trust and the plaintiff's
13 \$65,000 deed of trust, he knew that the
14 representation was false. He made the
15 representation with reckless indifference to
16 the truth solely to induce the plaintiff to
17 make the loan. Representations of value
18 "which the declarant does not, in fact, hold
19 or declarations made with reckless
20 indifference for the truth may be found to be
21 fraudulent." [Citations omitted.] "A false
22 statement regarding the value of property,
23 which is not made in good faith, and which is
24 not warranted by the knowledge or belief of
25 the owner, may furnish the basis of an action
26 for rescission on the ground of fraud or
deceit."

20 In Spar, the court considered the same issue, and stated:

21 Only when the debtor "does not hold these
22 opinions or utters them with reckless
23 indifference for their truth" can the
24 requisite fraud be found. . . . When, at the
25 time a representation is made, the debtor has
26 no intention of performing as promised, a
debtor's misrepresentation of his intentions
will constitute a false representation under
Code § 523(a)(2)(A).

26 176 B.R. at 326.

1 In In re Lund, 202 B.R. 126, 130-31 (9th Cir. BAP 1996), the
2 appellate court observed:

3 However, if the Debtors made false
4 representations regarding payment for the
5 purpose of inducing Kuan to permit them to
6 stay longer without paying rent, then the
7 Debtors obtained "property" (possession of
8 the house without presently making rent
9 payments) through "false pretenses, false
10 representation, or actual fraud" within the
11 meaning of 11 U.S.C. § 523(a)(2)(A)

12 Further, the representation that
13 the Debtors would pay the debt upon
14 receiving the proceeds of a lawsuit
15 is a promise, not a statement of fact.
16 A debtor must make a promise while knowing
17 it to be false at the time in order to
18 support a nondischargeability action under
19 11 U.S.C. § 523(a)(2)(A).

20 In 1989, the Ninth Circuit made similar statements in
21 In re Rubin, 875 F.2d 755, 759, where the court quoted from a
22 Florida bankruptcy decision. The court repeated:

23 "[O]pinions as to future events which the
24 declarant does not, in fact, hold or
25 declarations made with reckless indifference
26 for the truth may be found to be fraudulent."
[Citation omitted.] Moreover, even though
Rubin can characterize the second
representation as a promise, a promise made
with a positive intent not to perform or
without a present intent to perform satisfies
§ 523(a)(2)(A).

Curiously, Rubin says that at the same time that it recognizes
that a representation must be a representation of fact.

The cases are, at the least, confusing. If a statement of
opinion, for instance, of value, is not actionable because it
is not a representation of an existing fact, how does the lack

1 of a good faith belief in its accuracy transform it into a
2 representation of fact? It does not. Rather, the lack of good
3 faith belief or reckless disregard for the truth go to the second
4 element of a § 523(a)(2)(A) cause of action -- whether the
5 declarant knew it was false. That is a separate and independent
6 requirement, but proof of the known falsity does not make a
7 statement of opinion into an existing fact. The first element
8 still is that the representation, to be actionable, must be one
9 of an "existing and ascertainable" fact. Some suggest that the
10 false representation is the express or implicit representation
11 that the speaker "believes" it to be so. This Court disagrees.
12 Whether the speaker believes the statement or not does not turn a
13 non-actionable opinion into one a listener can sue on unless
14 there is some other duty on the speaker.

15 The cases which have consistently been the most troubling
16 under § 523(a)(2)(A) are the credit card cases, where courts
17 have wrestled with implied promises to perform and implied
18 representations, trying to shoehorn the creditors' claims into
19 the language of the statute.

20 Separate from the foregoing, but particularly relevant to
21 analysis of this case, is the actionability of a "representation"
22 from nondisclosure of a material fact. The court in In re
23 Tallant, 207 B.R. 923, 931 (Bankr. E.D. Cal. 1997) summed it up:

24 When evaluating a debtor's liability for
25 fraudulent nondisclosure, the Ninth Circuit
26 has turned to section 551 of the Restatement
(Second) of Torts (1976). [Citations
omitted.] Section 551 states:

1 (1) One who fails to disclose to
2 another a fact that he knows may
3 justifiably induce the other to act or
4 refrain from acting in a business
5 transaction is subject to the same
6 liability to the other as though he had
7 represented the nonexistence of the
8 matter that he has failed to disclose,
9 if, but only if, he is under a duty to
10 the other to exercise reasonable care to
11 disclose the matter in question.

12 (2) One party to a business
13 transaction is under a duty to exercise
14 reasonable care to disclose to the other
15 before the transaction is consummated,

16 (a) matters known to him that
17 the other is entitled to know
18 because of a fiduciary or other
19 similar relation of trust and
20 confidence between them;
21 (Emphasis added.)

22 Tallant continues:

23 As subsection (1) indicates, a
24 bargaining adversary ordinarily owes no duty
25 to disclose information acquired by his own
26 thrift or better business acumen. [Citation
omitted.] However, subsection (1)(a)
suspends this general rule for relationships
of trust and confidence and imposes an
affirmative duty of disclosure on the
fiduciary.

The Ninth Circuit, in In re Apte, 96 F.3d 1319, 1324 (1996)
looked at section 551 of the Restatement. In addition to quoting
subparts (1) and (2), the court looked at subpart (e) of subpart
(2), which also requires disclosure of:

(e) facts basic to the transaction, if he
knows that the other is about to enter
into it under a mistake as to them, and
that the other, because of the
relationship between them, the customs
of the trade or other objective
circumstances, would reasonably expect a
disclosure of those facts.

1 The court added:

2 Furthermore, a party to a business
3 transaction has a duty to disclose when the
4 other party is ignorant of material facts
5 which he does not have an opportunity to
6 discover.

7 96 F.3d at 1324.

8 In In re Eashai, 87 F.3d 1082, 1089 (9th Cir. 1996), a
9 credit card case, the court recognized "that a debtor's silence
10 or omission regarding a material fact can constitute a false
11 representation which is actionable under § 523(a)(2)(A)."

12 However, "[a]n omission gives rise to liability for fraud only
13 when there is a duty to disclose." See, also, Chiarella v.
14 United States, 445 U.S. 222, 228 (1980).

15 To return to the beginning, the first element of a cause of
16 action under § 523(a)(2)(A) is that debtor made a representation
17 of an existing or past fact. Such a representation may be made
18 affirmatively, or may be inferred by omission when the debtor has
19 a duty to disclose it.

20 2. Falsity of the Representation

21 The second element of a cause of action under § 523(a)(2)(A)
22 is that the debtor knew the representation was false when made.
23 As already noted, some courts appear to have elided the first and
24 second elements, suggesting that any kind of representation is
25 actionable if the declarant lacked a good faith belief in its
26 accuracy. See, In re Evans, 181 B.R. 508, 512 (Bankr. S.D. Cal.
1995); In re Spar, 176 B.R. 312, 327 (Bankr. S.D. NY 1994);

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1 In re Lund, 202 BR. 127, 130-31 (9th Cir. BAP 1996); In re Rubin,
2 875 F.2d 755, 759 (9th Cir. 1989).

3 This Court believes the language of the foregoing cases
4 really focuses on satisfaction of the second element -- that the
5 debtor knew the representation was false at the time it was made.
6 The opinion of the Bankruptcy Appellate Panel in In re Kong, 239
7 B.R. 815, 826-27 (1999) lays it out fairly well. There, the
8 court wrote:

9 The Ninth Circuit, as well as other
10 appellate courts, have recognized that
11 "reckless disregard for the truth of a
12 representation satisfies the element that the
13 debtor has made an intentionally false
14 representation in obtaining credit." . . .
15 The Ninth Circuit uses the phrase "reckless
16 indifference to his actual circumstances"
17 interchangeably with "reckless disregard for
18 the truth of a representation." . . .
19 [R]eckless conduct must involve more than
20 simple, or even inexcusable negligence; it
21 requires such extreme departure from the
22 standards of ordinary care that it represents
23 a danger of misleading [those whom [sic] rely
24 on the truth of the representation]." . . .
25 Fraudulent misrepresentation is established
26 where the maker of a statement chooses to
assert it as a fact even though he is
conscious that he has neither knowledge nor
belief in its existence "and recognizes that
there is a chance, more or less great, that
the fact may not be as it is represented."
. . . "This is often expressed by saying
that fraud is proved if it is shown that a
false representation has been made without
belief in its truth or recklessly, careless
of whether it is true or false." . . .
(" [R]eckless indifference to the actual
facts, without examining the available source
of knowledge which lay at hand, and with no
reasonable ground to believe that it was in
fact correct' [is] sufficient to establish
the knowledge element . . . which completely
bar[s] a discharge of all debts if the

1 bankrupt made a materially false statement in
2 order to obtain property on credit.")

3 3. Intent to Deceive

4 The third element of a § 523(a)(2)(A) cause of action is an
5 intent on the part of the debtor to deceive the creditor. It has
6 become axiomatic that direct proof of an intent to deceive is
7 rarely available. So courts have recognized that the requisite
8 intent to deceive may be inferred from proof of the surrounding
9 circumstances "if the facts and circumstances of a particular
10 case present a picture of deceptive conduct by the debtor."

11 In re Eashai, 87 F.3d 1082 (9th Cir. 1996).

12
13 4. Reliance

14 Even where a creditor can prove a knowingly false
15 representation was made, and further establish an intent to
16 deceive, a creditor generally cannot succeed unless the creditor
17 also can prove reliance on the false representation. Field v.
18 Mans, 516 U.S. 59 (1995). While § 523(a)(2)(A) does not, on its
19 face, expressly require reliance, the requirement has been
20 inferred from the fact that the debt must have been "obtained by"
21 the fraud or misrepresentation. Field, 516 U.S. at 66. That is,
22 the fraud must have caused the debt which, in turn, requires that
23 the claimant have relied upon the misrepresentation.

24 In Field, the Supreme Court addressed the level of reliance
25 required under (a)(2)(A). The Court held that reliance need not
26 be reasonable, as expressly required in § 523(a)(2)(B), but it

1 must be justifiable. The Court explained that "a person is
2 justified in relying on a representation of fact 'although he
3 might have ascertained the falsity of the representation had he
4 made an investigation.'" Id. at 70 [quoting § 540 Restatement
5 (Second) of Torts (1976)]. Unlike reasonable reliance, this is
6 a subjective standard - that is, it depends upon the knowledge
7 and experience of the person to whom the representations were
8 made. Citing to the Restatement of Torts, the Supreme Court in
9 Field explained:

10 [A] person is "required to use his
11 senses, and cannot recover if he blindly
12 relies upon a misrepresentation the falsity
13 of which would be patent to him if he had
14 utilized his opportunity to make a cursory
15 examination or investigation. Thus, if
16 one induces another to buy a horse by
17 representing it to be sound, the purchaser
18 cannot recover even though the horse has
19 but one eye, if the horse is shown to the
20 purchaser before he buys it and the slightest
21 inspection would have disclosed the defect.
22 On the other hand, the rule stated in this
23 Section applies only when the recipient
24 of the misrepresentation is capable of
25 appreciating its falsity at the time by the
26 use of his senses. Thus, a defect that any
experienced horseman would at once recognize
at first glance may not be patent to a person
who has had no experience with horses."
[Restatement (Second) of Torts (1976) § 541,
Comment a].

22 A missing eye in a "sound" horse is one thing;
23 long teeth in a "young" one, perhaps another.

24 Field, 516 U.S. at 71.

25 The Ninth Circuit Court of Appeals explains: "Although one
26 cannot close his eyes and blindly rely, mere negligence in

1 failing to discover an intentional misrepresentation is no
2 defense for fraud." Apte, 96 F.3d at 1322.

3 Notwithstanding that "reasonable" reliance is not required
4 to succeed under § 523(a)(2)(A), it still has a role in the
5 analysis of a court in determining nondischargeability. The
6 Supreme Court observed in Field:

7 As for the reasonableness of reliance,
8 our reading of the Act does not leave
9 reasonableness irrelevant, for the greater
10 the distance between the reliance claimed and
11 the limits of the reasonable, the greater the
12 doubt about reliance in fact. Naifs may
13 recover, at common law and in bankruptcy, but
14 lots of creditors are not at all naive. The
15 subjectiveness of justifiability cuts both
16 ways, and reasonableness goes to the
17 probability of actual reliance.

18 516 U.S. at 76.

19 Of course, affirmatively proving justifiable reliance is
20 much more difficult when the creditor did not know a material
21 fact because the debtor failed to disclose it while having a duty
22 to do so. The Ninth Circuit recognized that issue in In re Apte,
23 96 F.3d 1319 (1996). There, the court wrote:

24 In another context, that of securities
25 fraud, the Supreme Court has recognized the
26 difficulty of proving the reliance or
causation elements in a case of fraudulent
nondisclosure:

"Under the circumstances of this case,
involving primarily a failure to
disclose, positive proof of reliance is
not a prerequisite to recovery. All
that is necessary is that the facts
withheld be material in the sense that a
reasonable investor might have
considered them important in the making
of this decision. This obligation to

1 disclose and this withholding of a
2 material fact established the requisite
element of causation in fact."

3 Affiliated Ute Citizens v. United States, 406
4 U.S. 128, 153-54, 92 S.Ct. 1456, 1472, 31
L.Ed.2d 741 (1972) (citations omitted). See
5 also Titan Group, Inc. v. Faggen, 513 F.2d
6 234, 239 (2d Cir. 1975) ("In cases involving
nondisclosure of material facts, even when
7 coupled with access to the information,
materiality rather than reliance thus becomes
the decisive element of causation")

8 The reasoning of these securities cases
9 applies equally to fraud cases in the
bankruptcy context. Indeed, the
10 nondisclosure of a material fact in the face
of a duty to disclose has been held to
11 establish the requisite reliance and
causation for actual fraud under the
12 Bankruptcy Code.

13 5. Causation

14 Finally, to prevail under 11 U.S.C. § 523(a)(2)(A), a
15 creditor must establish that a claim sought to be discharged
16 arose from an injury proximately resulting from its reliance on
17 a representation that was made with the intent to deceive.
18 In re Britton, 950 F.2d 602, 604 (9th Cir. 1991). "Proximate
19 cause is sometimes said to depend on whether the conduct has been
20 so significant and important a cause that the defendant should be
21 legally responsible." Id. at 604. The United States Supreme
22 Court explained in Field, a court may turn to the Restatement
23 (Second) of Torts (1976), "the most widely accepted distillation
24 of the common law of torts" for guidance on this issue. Field,
25 516 U.S. at 68-70, 116 S.Ct. at 443.

26 ///

1 The Restatement (Second) of Torts (1976) explains that
2 proximate cause entails (1) causation in fact, which requires a
3 defendant's misrepresentations to be a substantial factor in
4 determining the course of conduct that results in loss (§ 546);
5 and (2) legal causation, which requires a creditor's loss to
6 "reasonably be expected to result from the reliance." (§ 548A).
7 In determining the presence of proximate cause, however, courts
8 must refrain from relying on speculation to determine whether and
9 to what extent a creditor would have suffered a loss absent
10 fraud. In re Siriani, 967 F.2d 302, 306 (9th Cir. 1992).

11 As illustrated, above, causation can be intertwined with
12 reliance, particularly in the circumstances of nondisclosure of
13 a material fact.

14 The foregoing is an over lengthy review of the law involving
15 § 523(a)(2)(A), but it is helpful in assessing the facts of this
16 case, which are unusual.

17 After working for others for some years in the industry,
18 debtor Gonzales decided to open his own store, and did so in
19 2002, selling doors through his dba "A Custom Door Company".
20 During the course of business customers routinely inquired about
21 hardware for the doors, and he and his employees would place
22 orders from catalogs from manufacturers such as Emtek and from
23 distributors such as Huntington Hardware.

24 Some time in 2003, Mr. Gonzales got the idea to expand his
25 business by creating an internet website which customers could
26 use to access catalogs, place orders, and pay by credit card. He

1 testified that he set up the website shopping place through
2 Monstercommerce.com, and initially said he filled out an
3 application at that website, but had no contact with plaintiff,
4 Bankcard Central. However, plaintiff's Exhibit 1 is a copy of a
5 Merchant Application with Bankcard Central's name and address on
6 it, which is filled out by hand and was apparently faxed on
7 October 3, 2003.

8 Exhibit 1 is a curious document in itself because the fax
9 markings in the upper right corner indicate it was a 7 page
10 document. However, only 6 pages are included, and only pages 1,
11 2, 3 and 4 bear the fax markings. The other 2 pages are fine
12 print provisions which do not have any markings on them, so it is
13 unclear whether some version of them were included in the faxed
14 application. However, Exhibit 1 was offered and received without
15 objection.

16 The two pages of fine print raise questions of their own.
17 The apparent beginning of the document reads:

18 This Merchant Services Agreement (the
19 "Agreement") is made as of the date of
20 acceptance by Provident Bank ("Bank") as set
21 forth on the signature page hereto, by and
22 among Bank, Bankcard Central, an independent
23 sales organization MasterCard Service
24 Provider ("BCC") and the business or entity
25 ("Merchant").

26 Whereas, Bank is engaged in the business
of purchasing bank card transactions from
merchants, BCC is a duly registered agent of
Bank and has agreed to provide certain
services related to the processing of card
transactions to Bank.

26 ///

1 Whereas, Merchant warrants that it has
2 not been terminated from settlement of card
3 transactions by any financial institution or
4 determined to be in violation of the rules
5 and regulations of Bank, MasterCard, Visa or
6 any other card association or network (Rules)
7 and Merchant acknowledges that Bank has
8 relied upon the information contained in the
9 Merchant Application in determining whether
10 to accept Merchant's application and in
11 setting the Discount Fee and Transaction Fees
12 charged Merchant.

13 Paragraph 1.8 of the fine-print pages relates to charge
14 backs, which is the source of Bankcard Central's claimed loss.
15 It provides in pertinent part:

16 1.8 Charge backs. Merchant will pay to
17 Bank upon demand and bear all risk of loss
18 without warranty of recourse to Bank for the
19 amount of any transaction plus applicable
20 fees due Bank or its representative . . . and
21 Bank shall have the right to debit Merchant's
22 incoming transactions, Merchant Account or
23 any other funds of Merchant in Bank's direct
24 or indirect control and to charge back such
25 transaction to Merchant

26 Paragraph 1.15 states:

 Merchant acknowledges that this
Agreement provides for PROVISIONAL SETTLEMENT
of Merchant's transactions . . . All payments
to merchant . . . shall be made by Bank
through the ACH and shall normally be
electronically transmitted directly to
Merchant's Account.

 Section 2 of the Agreement describes the "Bank's Rights and
Duties". Paragraph 2.1 says:

Bank shall accept from Merchant all Card
Transactions deposited by Merchant under the
terms of this Agreement and shall present the
same to the appropriate Card Issuers for
collection against Cardholder accounts . . .
Bank shall only provisionally credit the
value of collected Card Transaction to
Merchant's Account and reserves the right to

1 adjust amounts collected to reflect the value
2 of Chargebacks, fees, penalties, late
3 submission charges and items for which Bank
4 did not receive final payment.

4 One of the points in setting out so much of the Merchant
5 Agreement fine print is that the fine-print pages make it appear
6 that the Agreement is between the Bank (not Bankcard Central) and
7 Mr. Gonzales, doing business as ACDC Door Hardware. The fine-
8 print pages have five sections. Section One sets out the
9 "Merchant's Obligations and Duties", and section Two sets out
10 "Bank's Rights and Duties". There is no such section defining
11 Bankcard Central's rights, duties or obligations. That raises a
12 series of questions, starting with whether Bankcard Central is
13 the proper party plaintiff. What contract or agreement obligates
14 debtor to Bankcard Central, as distinct from the Bank? Among the
15 documents introduced there is on p.2 of the Merchant Application
16 (Ex. 1) an authorization to both the Bank and Bankcard Central to
17 initiate debit and credit entries, and that section refers to a
18 Merchant Processing Agreement, which has not been elsewhere
19 provided. Plaintiff's status was not challenged in the present
20 litigation, and for purposes of this proceeding the Court will
21 assume that Bankcard Central is the "duly registered agent" of
22 the Bank, as the fine-print pages indicate.

23 According to the testimony and documents submitted, a
24 customer would go on the internet to the website, review the
25 catalogs, place an order, and pay by credit card. Gonzales'
26 business would receive an e-mail advising of the order, customer

1 information, and the amount charged. ACDC would then order the
2 product from a manufacturer, such as Emtek, or from a
3 distributor, such as Huntington Hardware. If the manufacturer or
4 distributor would ship directly to the customer that might be
5 requested. Otherwise, the product would be delivered to ACDC,
6 which would then ship to the customer.

7 In the meantime, Bankcard Central would collect and process
8 the customers' credit card transactions and after deducting their
9 fees, cause funds to be electronically deposited in ACDC's
10 account. As the fine-print pages make clear, the Bank was
11 "purchasing" the credit card transactions from ACDC, while there
12 was no evidence of any communication or representation by ACDC or
13 Mr. Gonzales to Bankcard Central. According to Mr. Gonzales'
14 deposition testimony, only the internet transactions were
15 processed by Bankcard Central. Over-the-counter credit card
16 transactions were processed by a different company.

17 Under the foregoing structure of the business transaction, a
18 customer interacted with a computer website to place an order and
19 pay by credit card. There was no contact with anyone at ACDC,
20 and they only learned of the customer's order when they received
21 an e-mail generated by computer through the website. Bankcard
22 Central regularly collected the credit card transaction
23 information and processed each transaction through the bank that
24 issued the customer his or her card. Meanwhile, after deducting
25 applicable fees, Bankcard would deposit net funds into ACDC's
26 account, which ACDC would then use. If a customer was

1 dissatisfied with the product he received, or if he did not
2 receive it, he might return the product or complain to his credit
3 card issuer that he did not receive what he paid for. The
4 issuing bank would then process a "charge back", which would come
5 back to Bankcard Central. Bankcard Central, then, would debit
6 ACDC's account, as authorized in the Merchant Agreement.

7 The problem in this case arose from the fact that there came
8 a point in time when Bankcard Central attempted to charge back
9 transactions but there was no money in ACDC's account to collect
10 from. The testimony at trial of Bankcard's president was that
11 after all the dust had settled, the total of charge backs for "no
12 service" was \$180,578.98. In addition, the bank had charged a
13 processing fee, which accumulated to a total of \$2,384 in such
14 fees.

15 In handling charge backs, a customer contacts his or her own
16 bank and protests the charge. The customer's bank then gives
17 notice of the charge back, and the reason for it, to the payee
18 bank, here Provident and its agent Bankcard. The Merchant is
19 given notice of the charge back and has the opportunity to show
20 it is an improper charge back. Mr. Gonzales did not do so,
21 except that at trial he attempted to show that several customers
22 listed as charge backs had received the product they ordered, so
23 that if the charge back was for "no service" it was either wrong,
24 or incorrectly categorized for that reason.

25 While Mr. Gonzales disputed several of the charge backs
26 claimed by Bankcard, the evidence was largely un rebutted that

1 Bankcard Central sustained a loss of \$180,578.98 in charge backs,
2 plus \$2,384 in bank processing fees. Bankcard asks for a
3 judgment accordingly, and for a determination that the debt is
4 nondischargeable under § 523(a)(2)(A).

5 The gist of Bankcard's argument is that there came a point
6 in time in the Summer of 2005 when Mr. Gonzales accepted orders,
7 and payments from Bankcard on the credit card transactions,
8 when he knew he could not fill the orders. It is the acceptance
9 of the deposits by Bankcard when he knew he could not fill
10 the orders that constituted the fraud on Bankcard because
11 Mr. Gonzales had to know that at the end of the day Bankcard
12 would be left with a pile of charge backs that it could not
13 recover from Mr. Gonzales or ACDC.

14 ACDC's internet business was of relatively short duration.
15 The first customer transaction was around May, 2004. Rick
16 Julian, vice-president for sales and marketing at Emtek,
17 testified that total sales in 2004 to Mr. Gonzales was "just
18 under one million four." Net sales through July 2005 were just
19 over \$1,051,000. Mr. Gonzales testified that in early Summer,
20 when he received the prepared 2004 tax return, he realized he was
21 losing too much money, and would have to shut the business down.
22 He said he did shut it down, including the internet site on or
23 about July 31, 2005.

24 During operation of ACDC, the two major suppliers were EMTEK
25 and Huntington Hardware. EMTEK was a manufacturer and ACDC had
26 an account directly with them. Huntington was a distributor.

1 For reasons not specified at trial, EMTEK required payment in
2 advance from ACDC from shortly after starting the internet
3 business. ACDC would place an order with EMTEK, EMTEK would tell
4 them the approximate total and require payment of a certain
5 amount, and the final bill would be settled after shipment of the
6 orders against the payment already made.

7 In July, 2005, a number of orders had accumulated at EMTEK
8 but no payment had been received so EMTEK would not ship them.
9 Then ACDC packaged up a lot of EMTEK product and returned it to
10 EMTEK for a credit. Mr. Gonzales calculated the credit should be
11 \$56,907.85. He also claimed he sent \$3,988 of defective products
12 back, and he thought there wa a cash credit there of several
13 thousands of dollars.

14 When EMTEK received the returned product it did give ACDC a
15 credit, but only of \$37,423.04, almost \$20,000 less than the
16 returned merchandise (not including the defective products).
17 EMTEK then coupled that credit with whatever else it had on hand
18 and filled orders. Although Mr. Gonzales asked EMTEK to ship the
19 orders directly to the individual customers, EMTEK batched the
20 orders and shipped them to ACDC. By the time the shipment
21 arrived, ACDC had closed, and the orders were returned to EMTEK.
22 EMTEK thus had a credit due to Mr. Gonzales of \$43,892.39, which
23 it subsequently remitted to the trustee in this case upon
24 request. Because of its practice in dealing with Mr. Gonzales
25 and ACDC, EMTEK was not owed any money when ACDC shut down
26 operations.

1 While ACDC also dealt with 20-30 other suppliers, its other
2 major source of hardware was Huntington Hardware which is,
3 itself, a distributor of products manufactured by many different
4 companies. Huntington's arrangement with Mr. Gonzales provided
5 for payment after shipment, and Huntington wound up being owed
6 money at the end.

7 In its post-trial brief, Bankcard Central argued: 1) an
8 analogy to debtors who borrow when they know they cannot repay
9 the loan, or reckless disregard of whether the loan could be
10 repaid; 2) "fraudulent intent when he offered each credit
11 transaction for purchase by Bankcard Central"; 3) Gonzales was
12 "loading up" transactions in the last two months in anticipation
13 of a bankruptcy filing; 4) Gonzales "wrongfully induced plaintiff
14 to extend credit that Gonzales had no intention of repaying";
15 5) "Gonzales kept the proceeds he received from selling the
16 transactions to plaintiff, knowing the charge-backs would be
17 coming"

18 The Court's difficulties with Bankcard's arguments are that
19 they do not fit the facts adduced at trial, and they involve an
20 attempt to shoehorn these unusual facts into the body of law
21 under § 523(a)(2)(A). For example, the second argument,
22 structures the transaction to involve Mr. Gonzales "offering"
23 each credit transaction to Bankcard, much like an implicit
24 representation when a credit card user offers the card for
25 payment. But there is no evidence that Mr. Gonzales "offered"
26 any credit card transactions. Rather, at least so far as the

1 record discloses, Bankcard pulled the transactions from the
2 website, purchased them, deposited the net proceeds in ACDC's
3 account as provisional settlement of the sale, and then set out
4 to collect from the customer's issuing bank. There is no
5 evidence of any offer of a credit card transaction (aside from
6 the original Merchant Application), much less any representation
7 about the transaction or Mr. Gonzales' intent.

8 The third argument is that Mr. Gonzales was "loading up" in
9 the two months before closing. However, "loading up" involves a
10 debtor running up his or her own credit obligations by tendering
11 credit cards, while contemplating bankruptcy. Here, ACDC and
12 Mr. Gonzales were passive participants until after orders were
13 placed and the credit card transactions made by customers were
14 completed. They did not go out seeking the transactions in
15 anticipation. While the bankruptcy was filed less than three
16 months after closing the business, there was no evidence offered
17 that it was ever contemplated before the business shut down.

18 The fourth argument about inducing Bankcard to extend credit
19 just isn't supported by the facts. There was no evidence of
20 offer or inducement, and the transaction set up by Exhibit 1 was
21 not a credit transaction but a purchase and sale.

22 The fifth argument is not particularly clear. Certainly,
23 Mr. Gonzales did receive and expend the funds deposited to his
24 account by Bankcard. Although it was not a subject of any
25 evidence, at some point in time Mr. Gonzales might even have
26 anticipated some charge backs were likely. But retaining the

1 monies Bankcard deposited in the account was not, in itself, a
2 fraud on Bankcard.

3 Bankcard's first argument suffers from deficiencies similar
4 to the second and fourth. The orders were placed by customers
5 over the internet, and payment made by credit card, all before
6 Mr. Gonzales and ACDC knew anything about the transaction.

7 Bankcard's central argument really is that at some point in
8 time Mr. Gonzales had to know that he had received payment for
9 more orders than he could fill, and should have shut down the
10 website, taken no more orders and reversed charges on those he
11 could not fill. In point of fact, much the same could be said
12 for virtually every business that fails and leaves creditors
13 unpaid, whether it is a restaurant, with a landlord, employees,
14 and suppliers, or a hardware store.

15 The record in this case does not support a finding that
16 Mr. Gonzales intended to defraud Bankcard. Even at the end,
17 Mr. Gonzales was trying to get orders filled. He returned to
18 EMTEK what he believed at the time was over \$56,000 worth of
19 product for credit. He testified he believed he had additional
20 credit there already on his account. Despite his contemporaneous
21 calculation that the credit should be \$56,907.85, EMTEK gave him
22 a credit of \$37,423.04. EMTEK then added to that credit some
23 additional credit and shipped \$43,892.39 worth of product, which
24 was returned, and that amount paid to the trustee. Those figures
25 indicate EMTEK had a credit on its books of at least \$6,469.35 to
26 add to the return credit. Interestingly, EMTEK's July 29, 2005

1 letter (Ex. BG-5) lists orders released to ship, orders that were
2 cancelled, and orders totalling \$16,203.20 which would not be
3 shipped because no payment on them had been made and no credit
4 remained. If Mr. Gonzales' value of the return items of \$56,907
5 is accurate and is combined with the \$6,469 credit on the books,
6 there would have been enough credit at EMTEK to ship all the
7 outstanding orders. Far from "loading up", it looks more like
8 Mr. Gonzales was trying to get orders filled for customers who
9 had paid, at least as to EMTEK, by returning store inventory for
10 credit.

11 Bankcard has argued in support of its views that
12 Mr. Gonzales should not be allowed to characterize himself as a
13 bad businessman. At the same time, Bankcard introduced the
14 testimony of Huntington's president, Michael O'Shay, by
15 deposition. He testified in part:

16 A: I was looking at what he was buying the
17 material for and I was looking at what he was
18 selling the material for, and I looked around
19 at his overhead and it did not make sense.

20 Q: . . . everybody was starting to wonder,
21 "How can this guy make a profit with the
22 prices he was selling it at?" When I visited
23 his location and I saw a staff of five or six
24 people and I realized, in my mind a light
25 went off that it did not add up.

26 Transcript of O'Shay deposition, pp. 27-28.

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28 ///

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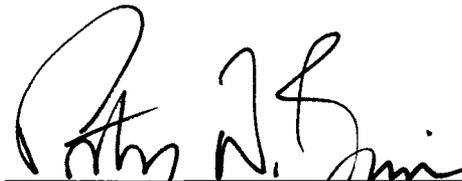
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1 In the last analysis, the Court finds that Bankcard Central
2 has failed to carry its burden of proof that Mr. Gonzales
3 committed fraud on Bankcard, or that he made any
4 misrepresentations (whether affirmatively or by omission) that
5 make his debt to Bankcard nondischargeable under 11 U.S.C. § 523
6 (a) (2) (A).

7 Accordingly, judgment shall enter for defendant Gonzales and
8 against plaintiff Bankcard Central.

9 IT IS SO ORDERED.

10 DATED: MAR 23 2007

11
12 
13 PETER W. BOWIE, Chief Judge
United States Bankruptcy Court

UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re Adv. Case No. 05-90521-B7
Bankruptcy Case No. 05-09757-B7

CERTIFICATE OF MAILING

The undersigned, a regularly appointed and qualified clerk in the office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to wit:

MEMORANDUM DECISION

was enclosed in a sealed envelope bearing the lawful frank of the Bankruptcy Judges and mailed to each of the parties at their respective address listed below:

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Said envelope(s) containing such document were deposited by me in a regular United States mail box in the City of San Diego, in said district on March 23, 2007.



Barbara J. Kelly, Judicial Assistant