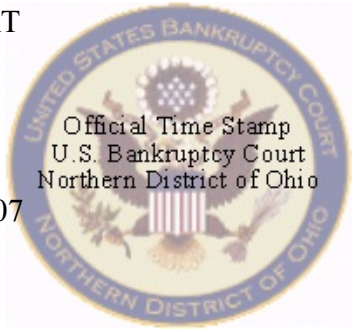
UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 11-15007
	)	
AMY GARDNER,	)	Chapter 7
	)	
Debtor.	)	Chief Judge Pat E. Morgenstern-Clarren
	)	
_____	)	
	)	
ELGIN FURNITURE NORTHFIELD, INC.,	)	Adversary Proceeding No. 11-1258
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
AMY GARDNER,	)	**MEMORANDUM OF OPINION**
	)	**AND ORDER**
Defendant.	)	

In 2010, the debtor Amy Gardner, a long time customer of plaintiff Elgin Furniture Northfield, Inc., borrowed money from Elgin to finance the purchase of bunk beds and a dining room set. She did not repay the money, Elgin sued her, and they entered into a consent judgment. Several weeks later when the debtor filed her bankruptcy case, Elgin filed this adversary proceeding seeking a determination that the original debt is not dischargeable under Bankruptcy Code § 523(a)(2)(A) because the debtor obtained the furniture through "false pretenses, a false representation, or actual fraud." The debtor opposed a finding of nondischargeability and asked for an award of costs and fees under § 523(d), contending that Elgin was not substantially justified in filing the complaint.

Elgin dismissed its complaint before trial and the case went forward on the debtor's § 523(d) claim. For the reasons stated below, judgment will be entered in favor of the debtor in an amount to be determined after further proceedings.

I. JURISDICTION

Jurisdiction exist under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I) and (O), and this decision is within the court's constitutional authority as analyzed by the United States Supreme Court in *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

II. FACTS

A.

The debtor presented her case through her own testimony and the cross-examination of Jed Brenner, Elgin's president, and Hilary Hall, Elgin's vice president and in-house counsel. Elgin presented its case through the testimony of Mr. Brenner and Ms. Hall (who are father and daughter), together with the cross-examination of the debtor. Both parties offered exhibits which were accepted into evidence.

These findings of fact reflect the court's weighing of the evidence, including determining the credibility of the witnesses. In doing so, the court considered the witnesses' demeanor, the substance of the testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language or nuance of expression. *See* FED. R. BANKR. P. 7052 (incorporating FED. R. CIV. P. 52).

B.

These are the facts that Elgin had in front of it when it decided to file the complaint alleging that the debtor committed fraud in her purchase:

Elgin sells a broad range of entry-level, affordable furniture. About 50% of its customers choose to finance their purchases with either Elgin or a third party. Elgin offers 24 month financing.

The debtor is employed at Medical Mutual and earns about $36,000.00 a year. She made her first financed purchase with Elgin in December 2000. Starting with the February 2001 payment, the debtor made 18 late payments and incurred late fees for each of those.[1] At some point during the payment period, the debtor filed a chapter 7 bankruptcy and paid part of the debt through that case.

The parties entered into a second financed contract in June 2005.[2] The debtor made the first four payments on time, and then rolled over the balance into a third loan. Two months later, the debtor made a lump sum payment that paid this loan in full.[3]

The parties entered into a fourth financed contract in July 2008.[4] Four months later, the debtor filed a chapter 13 bankruptcy.[5] Over the two-year contract period, she incurred 15 late fees, up to and including the June, July, and August 2010 payments. The debtor converted her

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[1] Exh. 3 (also attached as an exhibit to Elgin's complaint).

[2] Exh. 3 and Exh. 4.

[3] Exh. 3 and Exh. 5.

[4] Exh. 3 and Exh. 6.

[5] *In re Amy Gardner*, case no. 08-18917 (Bankr. N.D. Ohio).

case to chapter 7 in August 2010 and dismissed it in October 2010. The debtor paid this loan in full the same month.[6]

The fifth transaction is the one at issue. On November 26, 2010, the debtor financed a purchase in the amount of $1,982.51 at 24.99% interest over 24 months.[7] Before agreeing to extend credit, Elgin reviewed the debtor's credit application, contacted two references, reviewed a recent pay stub, considered her Elgin payment history, and drew a credit report.[8]

On March 30, 2011, Elgin filed suit against the debtor in Bedford Municipal Court, alleging that the debtor owed $1,985.16 on her account plus interest from March 21, 2011 at the rate of 24.99% and costs. Elgin prepared, and the unrepresented debtor signed, a consent judgment in which the debtor agreed to pay $1,985.16 plus interest at the rate of 24.99% and costs, at the rate of $105.78 per month with the first payment due June 15, 2011. Before the state court judge signed the judgment entry on May 20, 2011, he amended it to reduce the interest rate from 24.99% to 4% from the date of judgment.

The debtor filed this case on June 9, 2011. Attorney Hilary Hall attended the first meeting of creditors and offered to enter into a reaffirmation agreement[9] with the debtor for $1,200.00 with interest at 4%. The debtor's counsel, Robert Berk, countered with an offer in the range of $600.00 to $800.00. Attorney Hall declined.

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[6] The testimony did not address how the debtor treated this debt in her chapter 13 plan.

[7] Exh. 7.

[8] The parties stipulated that the substance of that credit report is not admissible into evidence.

[9] 11 U.S.C. § 524(c).

The next contact took place by email, with Attorney Hall writing to Attorney Berk:

> I represent Elgin Furniture who has a secured installment contract with your client Ms. Gardner. I spoke with you at the 341 hearing where you stated that a reaffirmation agreement was a waste of your time. My client requested that I file an adversary proceeding against Ms. Gardner. It seems unreasonable, and potentially costly, that you refuse to have your client sign the reaff [reaffirmation agreement] seeing you have listed Elgin in the expenditures. However, I will file the adversary on Monday, the deadline, if I do not get the signed reaff back tomorrow. I have attached the reaff I presented to you at the hearing.[10]

The attached reaffirmation agreement lists an original balance due of $2,098.07 at 24.99% interest.

Elgin then filed this adversary proceeding in which it asked the court to (1) grant judgment in the amount of $2,098.07, plus interest at 24.99% from June 9, 2011 forward and costs, and (2) declare the debt nondischargeable. Ms. Hall testified that she considered these factors before filing the complaint: the debtor had in the past always made the first payments due, followed either by making "perfect payments" or ultimately paying the account in full even if the payments were late and late charges were incurred; the debtor did not have any employment changes; the debtor had consented to the state court judgment, but had not paid; the debtor scheduled the Elgin debt as unsecured, but included a monthly payment amount in the budget; and the debtor's bankruptcy history. From this, Ms. Hall concluded that the debtor made a "false representation" at the time of purchase, which was that she intended to make the payments, when she never really intended to do so. Ms. Hall then consulted with Mr. Brenner, who agreed that Elgin should file.

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[10] Exh. 9.

Ms. Hall also testified as to what she meant in her email when she wrote that it "seems unreasonable, and potentially costly, that you refuse to have your client sign the reaff [reaffirmation agreement] seeing you have listed Elgin in the expenditures." She said that by "costly" she was just referring to the fact that the filing fee for an adversary proceeding is $260.00, and the debtor would have to pay that. She also said that this referred to the full debt amount versus the reduced reaffirmation amount. The court did not believe this explanation, and finds that Ms. Hall was threatening the debtor with having to pay more legal fees to defend the adversary proceeding if she refused to enter into the reaffirmation agreement.[11]

After the debtor filed her § 523(d) request and interrogatories, and Elgin consulted outside counsel, Elgin decided to dismiss its complaint. Elgin had not conducted any discovery.

At trial, the debtor testified as to facts relating more to whether she had committed fraud than to whether Elgin should be responsible for her attorney fees. She stated that she intended to file another bankruptcy case when she purchased the furniture, but that she was "not going to include this debt in the bankruptcy;" i.e., she was going to continue making payments. The court believed this testimony, as well as the debtor's testimony that she failed to make any payments because she ran into unexpected problems after making the purchase. These included a stoppage in child support payments and an unanticipated large expense when her daughter transferred from one college to another. This, plus supporting her other three children and trying to keep up her house and car payments caused her to fall behind on many obligations. When the debtor failed to make any payments to Elgin and Elgin made collection phone calls, the debtor told them that they could come and pick up the furniture. They did not do so.

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[11] Exh. 9.

III. DISCUSSION

A. 11 U.S.C. § 523(d)

Generally, an individual chapter 7 debtor receives a discharge of all debts at the end of the bankruptcy process. There are exceptions, including where the debtor obtained property through a "false representation." 11 U.S.C. § 523(a)(2)(A). For Elgin to exclude its debt from discharge under that provision, Elgin would have had to prove by a preponderance of the evidence that:

> (1) the debtor obtained money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied on the false representation; and (4) its reliance was the proximate cause of loss.

Rembert v. AT&T Universal Card. Servs., Inc. (In re Rembert), 141 F.3d 277, 280-81 (6th Cir. 1998) (footnote omitted).

Congress was concerned that the threat of litigation under § 523(a)(2) would induce consumer debtors to settle for a reduced sum to avoid the costs of litigation, even though they were entitled to a discharge of the debt. *See Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985) (discussing the legislative history for § 523(d)). To address this, Congress included a provision that if a creditor requests a nondischargeability finding, and if the debt is ultimately discharged:

> the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. § 523(d). To be awarded costs and attorney fees under this provision, " a debtor must establish that '(1) the creditor requested a determination of the dischargeability of the debt [under § 523(a)(2)], (2) the debt is a consumer debt, and (3) the debt was discharged.'" *Swartz v. Strausbaugh (In re Strausbaugh)*, 376 B.R. 631, 636 (Bankr. S.D. Ohio 2007) (quoting *Am. Sav. Bank v. Harvey (In re Harvey)*, 172 B.R. 314, 317 (B.A.P. 9th Cir. 1994) (alteration in original)). "Once the debtor establishes these three elements, the burden then shifts to the creditor to prove either that its position was substantially justified or that special circumstances exist that would make an award of costs and attorney fees unjust." *Id.* (citing *Colabianchi v. Thomas (In re Thomas)*, 258 B.R. 167, 168 (Bankr. N.D. Ohio 2001)); *see also Thorp Credit, Inc. v. Carmen (In re Carmen)*, 723 F.2d 16, 17 (6th Cir. 1983) (stating that the creditor had the burden of proving that a fee award would be inequitable under the prior version of §523(d)).

A determination regarding substantial justification "should turn on a totality of the circumstances." *AT&T Universal Card Servs. Corp. v. Williams (In re Williams)*, 224 B.R. 523, 531 (B.A.P. 2d Cir. 1998); *see also In re Thomas*, 258 B.R. at 169. The standard has been interpreted to mean that the creditor's position was justified to a degree that would satisfy a reasonable person. *See Bridgewater Credit Union v. McCarthy (In re McCarthy)*, 243 B.R. 203, 207 (B.A.P. 1st Cir. 2000) (noting that the standard was modeled after a fee provision in the Equal Access to Justice Act and adopting the standard for that provision stated in *Pierce v. Underwood*, 487 U.S. 552 (1988)); *In re Williams*, 224 B.R. at 530-31 (same). These three criteria are considered: (1) was there a reasonable basis in law for the theory propounded; (2) was there a reasonable basis in truth for the facts alleged; and (3) was there a reasonable connection between the facts alleged and the legal theory advanced. *Id.* Although this standard

is similar to the one that applies to a motion for sanctions under Federal Bankruptcy Rule 9011, the creditor actually has a somewhat higher burden than a party trying to defeat a Rule 9011 motion. *In re McCarthy*, at 209.

The requirement that a creditor's position must be substantially justified applies throughout the prosecution of the case. *People's Bank v. Poirier (In re Poirier)*, 214 B.R. 53, 57 (Bankr. D. Conn. 1997). Consequently, "[s]ection 523(d) provides creditors with a strong incentive to determine the existence of a basis, i.e., 'substantial justification,' for commencing and continuing prosecution of a dischargeability complaint." *Id.* at 56.

Section 523(d) also provides that the court shall not award fees and costs where "special circumstances" would make an award unjust. The parameters of this provision are not clearly defined by the case law. There is agreement, however, that this exception should be interpreted under traditional equitable principles. *First Card v. Hunt (In re Hunt)*, 238 F.3d 1098, 1104 (9th Cir. 2000); *In re Hingson*, 954 F.2d 428, 429-30 (7th Cir. 1992); *In re McCarthy*, 243 B.R. at 210.

B. The Positions of the Parties

The parties agree that the debt was a consumer debt,[12] Elgin sought a § 523(a)(2) determination of dischargeability, and the debt has been discharged. The only issue is whether Elgin was substantially justified in filing and pursuing its complaint, or whether special circumstances make an award of fees and costs inappropriate under § 523(d).

[12] In this context, consumer debt "means debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8).

The debtor argues that Elgin was not substantially justified in filing the complaint because the debtor did not make a false representation when she accepted the credit. She made the same representations that she had over the years; i.e., that she was employed at Medical Mutual at a salary that Elgin verified. Elgin knew about her checkered payment history and her two bankruptcy filings. Her failure to pay resulted not from fraud, but from an unforeseen change in circumstances.

Elgin, on the other hand, maintains that it was substantially justified in concluding that the debtor falsely represented that she would pay for the furniture when she bought it. As part of the totality of the circumstances, Elgin argues that it did due diligence before making the loan and that the debtor broke her promises, including by planning to file another bankruptcy case. Additionally, Elgin tried to resolve the issue through offering a reaffirmation agreement, but the debtor refused to enter into such an agreement or return the furniture. Elgin reiterated that Attorney Hall's reference to cost just related to the filing fee, and to the potentially higher amount the debtor would owe if she lost the dischargeability issue, not to the attorney fees that the debtor would have to incur after the filing. Elgin also notes the "special circumstances" provision, but did not identify any particular fact outside of the ones that it relies on to show substantial justification.

C. Is the Debtor Entitled to an Award Under § 523(d)?

There are two parts to the analysis of whether Elgin was substantially justified in filing its complaint: the amount of the debt pursued and whether it was nondischargeable based on fraud.

1. The Amount Claimed as Due in the Complaint

As to the first issue, Elgin sought a determination of nondischargeability for a debt in the amount of $2,098.07 with interest at 24.99% despite having entered into an agreed judgment for the lower amount of $1,985.16 plus interest at 4%. Elgin did not have a reasonable basis in fact or law to request this amount because the amount due had already been determined in the state court judgment. 28 U.S.C. § 1738; *Bay Area Factors, Inc. v. Calvert (In re Calvert)*, 105 F.3d 315, 317 (6th Cir. 1997).

When faced with a state court judgment, the bankruptcy court must look to state law to determine its preclusive effect. *In re Calvert*, 105 F.3d at 317. Under Ohio law, the legal doctrine of res judicata includes two related but different preclusion concepts: claim preclusion and issue preclusion. *Am. Home Prods. Corp. v. Tracy*, 787 N.E.2d 658, 661 (Ohio Ct. App. 2003). Claim preclusion holds "that 'a valid, final judgment rendered on the merits bars all subsequent actions based upon any claim arising out of the transaction or occurrence that was the subject matter of the previous action.'" *Corzin v. Fordu (In re Fordu)*, 201 F. 3d 693, 703 (6th Cir. 1999) (quoting *Grava v. Parkman Twp.*, 653 N.E.2d 226, 229 (Ohio 1995)). Claim preclusion has four elements under Ohio law: "(1) a prior final, valid decision on the merits by a court of competent jurisdiction; (2) a second action involving the same parties, or their privies, as the first; (3) a second action raising claims that were or could have been litigated in the first action; and (4) a second action arising out of the transaction or occurrence that was the subject matter of the previous action." *Id.* 703-4.

Elgin's consent judgment is preclusive as to the debtor's liability and the amount of that liability. The state court action involved the same parties as this proceeding, and the consent

judgment resolved Elgin's claim for its past due balance, which was also one of the issues being litigated here. Additionally, as Ohio courts have determined that a consent judgment is a judgment on the merits, Elgin's judgment is a final determination on the merits by a court of competent jurisdiction. *See Gilbraith v. Hixson*, 512 N.E.2d 956, 959 (Ohio 1987) (stating that "as a general rule, a consent judgment operates as res judicata with the same force given to a judgment entered on the merits in a fully adversarial proceeding"); *Packer, Thomas & Co. v. Eyster*, 709 N.E.2d 922, 928 (Ohio Ct. App. 1998) ("It has been held that a judgment entered by agreement is the same as if adjudicated on the merits . . . for purposes of res judicata"). Because the Ohio judgment established the debtor's liability to Elgin on the account and the amount of that debt, Elgin did not have a factual or legal basis for asking for a higher principal amount or the dramatically higher interest rate (24.99% v. 4%) in its complaint.

2. The False Representation Claim

The next consideration is whether Elgin was substantially justified in claiming that the debtor obtained the furniture through a false misrepresentation, specifically that she intended to pay for the furniture when she did not intend to do so. Elgin relies heavily on the fact that the debtor did not make the first payment, arguing that this shows that she did not intend to make any payments. While this is relevant, it is not conclusive. The debtor's first payment was due January 1, 2011 with a 14-day grace period. Elgin sued the debtor on March 30, 2011, so Elgin must have made the collection phone calls between January 16, 2011 and March 30, 2011. The debtor told Elgin during at least one of those calls that it could come and pick up the furniture. This is not the behavior of someone who made a purchase several weeks earlier not intending to pay for it; it is the behavior of someone who initially thought she could afford the furniture but

then found she could not. Elgin should have, but did not, consider the debtor's response to the collector in making its decision to sue.

Elgin also points to the debtor's trial testimony that she intended to file another bankruptcy when she purchased the furniture, but also intended to continue to pay this debt. First, Elgin did not know this when it filed the complaint, which makes it of dubious importance to the current issue. Nevertheless, the debtor's intention to pay for the furniture regardless of any additional bankruptcy filing does not support Elgin's claim that the debtor did not intend to pay when she bought the furniture.

The debtor's refusal to enter into a reaffirmation agreement is not evidence that she made a false representation when she bought the furniture. No debtor is required to reaffirm a debt; the debtor was within her rights to decline to sign the agreement proffered by Elgin. The debtor had already offered to return the furniture. If Elgin wanted to repossess the furniture, it could have done so, proceeding according to law if for some reason it felt that the debtor had changed her mind about the voluntary return.[13]

The remaining fact that Elgin points to is that the debtor entered into the consent judgment, but did not make any payments; again, Elgin argues, a broken promise. A broken promise is not, however, necessarily fraud. It is not surprising that an unrepresented debtor in financial trouble would sign such an agreement. There was no testimony as to what

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[13] After obtaining the state court judgment, Elgin still had the right to proceed against the collateral. Under Ohio law, after default, a secured party may (among other things) "reduce a claim to judgment, foreclose, or otherwise enforce the claim, [or] security interest . . . by any available judicial procedure[.]" OHIO REV. CODE § 1309.601(A)(1). These rights are cumulative and may be exercised simultaneously. OHIO REV. CODE § 1309.601(C). Of course, the creditor is only entitled to one satisfaction of the debt.

conversations, if any, took place between Elgin and the debtor that led to this judgment. This fact is relevant but not sufficient–either alone or in combination with the other facts–to establish a reasonable belief that the debtor committed fraud at the outset.

Given the ambiguous facts that Elgin had, Elgin could have, but did not, examine the debtor under oath before filing the complaint. *See* FED. R. BANKR. P. 2004. Had Elgin done so, it would have had the benefit of the debtor's explanation for her actions.

After balancing all of the facts, the court concludes that this is what happened: Elgin's representatives, irritated that the debtor would not enter into a reaffirmation agreement, filed the nondischargeability complaint for that reason and not because they genuinely concluded that the debtor had made a false representation at the time of the transaction. Elgin did not show, based on all the circumstances, that it was substantially justified in filing the complaint.

3. The Special Circumstances Provision

Elgin did not identify any special circumstances that would make it unjust to award fees to the debtor. According to Elgin, it markets to consumers who are willing to purchase lower end furniture, some of whom decide to finance those purchases at interest rates in the range of 25%. This transaction falls within the ordinary course of Elgin's business. Moreover, Elgin had the benefit of both corporate and legal advice before making its decision to file the adversary proceeding. The bargaining and decision making power all favored Elgin. Elgin did not, therefore, prove that equity makes this award unjust.

IV. CONCLUSION

For the reasons stated, the court concludes that the debtor is entitled to judgment on her § 523(d) claim. Debtor's counsel filed fee statements in support of the debtor's request for an award of her attorney fees.[14] If Elgin objects to the reasonableness of the fee request, it is to file an objection by **March 6, 2012**. The court will determine the appropriate amount of the award based on those filings and will enter a judgment for that amount.

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
Chief Bankruptcy Judge

[14] The court admitted counsel's initial fee statement into evidence at the hearing. (Docket 21). Counsel filed a supplemental statement after the hearing. (Docket 32).

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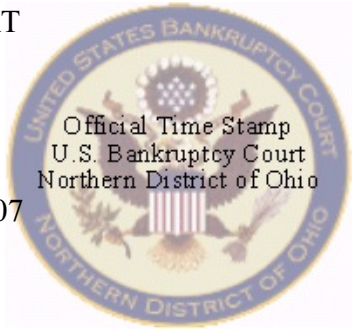

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ELGIN FURNITURE NORTHFIELD, INC.,	)	Adversary Proceeding No. 11-1258
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
AMY GARDNER,	)	**JUDGMENT**
	)	
Defendant.	)	

The court held that the defendant-debtor Amy Gardner is entitled to judgment on her 11 U.S.C. § 523(d) claim in a memorandum of opinion entered on February 27, 2012, with the issue of the amount of the award to be determined after further submissions. (Docket 34). The parties have now stipulated that the amount of the award is to be $8,200.00. (Docket 36). Therefore, for the reasons stated in the memorandum of opinion, the defendant debtor is awarded $8,200.00 on her § 523(d) claim.

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
Chief Bankruptcy Judge