

**IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT**

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IN THE MATTER OF CONSTANCE P. MERCER,

*Debtor,*

AT & T UNIVERSAL CARD SERVICES,

*Plaintiff-Appellant,*

v.

CONSTANCE P. MERCER,

*Defendant-Appellee.*

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

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**BRIEF OF AMICUS CURIAE  
NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS  
IN SUPPORT OF DEFENDANT/APPELLEE  
ON REHEARING EN BANC**

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**CORPORATE DISCLOSURE STATEMENT  
AND STATEMENT OF INTEREST OF NACBA  
AS AMICUS CURIAE**

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 1,400 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 300,000 bankruptcy cases filed each year. Fifth Circuit NACBA members file many thousands of bankruptcy cases per year.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues which cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various appellate courts seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Kawaauhau v. Geiger*, 118 S.Ct. 974 (1998).

The NACBA membership has a vital interest in the outcome of this appeal. NACBA members primarily represent individual low- and moderate-income wage-earners. Many of the bankruptcy cases filed by such wage-earners involve the discharge of credit card debt. Too often, card companies have threatened to file or have filed non-dischargeability actions based on the slimmest evidence of actual fraud by the debtor, or in situations where actual and justifiable reliance cannot be proved. Such actions may be threatened or filed simply to coerce a settlement because debtors may not have the financial wherewithal to incur litigation costs. *See, e.g., In re Grayson*, 199 B.R. 397 (Bankr. W.D.Mo. 1996).

The *en banc* Court's ruling in this case is critical to individual debtors who wish to obtain a fresh start. *Amicus* is particularly concerned that a reversal of the panel majority opinion would eviscerate the strict fraud requirements found in § 523(a)(2)(A) and impermissibly shift the burden of proof in such cases.

## **ARGUMENT**

### **I. THE PANEL'S MAJORITY HOLDING THAT THE APPELLANT FAILED TO PROVE JUSTIFIABLE RELIANCE SHOULD BE UPHELD.**

#### **A. The Credit Card Industry's Underwriting Practices Depart Significantly From Those Of Traditional Lenders In That Credit Decisions Are Not Based On Representations Made By Consumers.**

The credit card application and underwriting process is extraordinary.

Unlike all other forms of conventional financing, credit card lenders make unsolicited offers of credit without seeking or obtaining basic information regarding an applicant's creditworthiness. Such lenders do not request applicants to provide information about their "expenses, assets, nature of employment or business, health, home ownership, credit references or general financial condition." In re Akdogan, 204 B.R. 90, 92 (Bankr.E.D.N.Y. 1997); *see also* In re Mercer, 220 B.R. 315, 319 (Bankr.S.D.Miss. 1998) ("no questions asked about where [debtor]

worked, her financial condition, how many children she had ...”); In re Leonard, 158 B.R. 839 (Bankr.D.Colo. 1993). In most cases, credit card companies do not review applicants’ credit bureau reports or request applicants to disclose the total amount of their outstanding debt. Even an applicant’s income and job history are typically disregarded.

Instead, the credit card industry uses pre-screening systems that enable them to obtain lists of potential customers who have certain characteristics deemed desirable based on data available at the three major credit bureaus. For instance, a lender may obtain a list from a credit bureau of consumers who have no judgments or bankruptcies, no accounts past due more than 60 days, and total revolving (credit card) debt outstanding of less than \$10,000. However, until a firm offer is made and the consumer accepts, the Fair Credit Reporting Act limits the information that can be provided to the card company. Only the name and address of the consumer, an “identifier that is not unique to the consumer” to be used solely for identification purposes, and “other information pertaining to a consumer that does not identify the relationship or experience of the consumer with respect to a particular creditor or other entity.”<sup>1</sup> 15 U.S.C. § 1681b(c)(2).

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<sup>1</sup> Of course, once the consumer accepts the firm offer, nothing in the Fair Credit Reporting Act prohibits a lender from obtaining a full credit bureau report or seeking additional information in a credit application, and lenders may withdraw the offer based on negative information in the report or application that is inconsistent with the lender’s pre-screening selection criteria. *See* 15 U.S.C. §1681a(l).

The pre-screening process also involves a credit rating system developed by Fair, Isaac & Co. used by card companies to target potential customers for solicitations. The system produces a number for each consumer, commonly known as a “FICO score”, based on a “mathematical equation” that evaluates various forms of credit bureau information. *See*, “Understanding Your Credit Score,” Fair, Isaac & Co. ([www.fairisaac.com](http://www.fairisaac.com)). Lenders obtain FICO scores from each of the three major credit bureaus, who actually perform the score calculation under the Fair, Isaac model using the credit data in their respective systems. <sup>2</sup>

Fair, Isaac does not specify the level of an acceptable score. Lenders are free to set their own minimum score depending upon the credit product being offered, and there is “no single ‘cutoff score’ used by all lenders.” *Id.* <sup>3</sup>

While the exact details of the mathematical formula remain proprietary, Fair, Isaac has attempted to debunk the mystery of FICO scores with its recent publication of a list of score factors and supporting explanation. *Id.* <sup>4</sup>

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<sup>2</sup> FICO scores on individual consumers may vary as between credit reporting agencies depending upon the information each has available.

<sup>3</sup> As in this case, the caselaw suggests that a cutoff score of 680 is used by several lenders to identify potential customers for credit card solicitations. *See, e.g., In re Mercer*, 211 F.3d 214, 215 (5<sup>th</sup> Cir. 2000); *In re Ellingsworth*, 212 B.R. 326 (Bankr.W.D.Mo. 1997); *In re Rich*, 249 B.R. 709 (Bankr.N.D.Tx. 2000).

<sup>4</sup> The five major categories of information comprising the FICO score are: 1) payment history on past credit accounts, including any past due accounts (35% of score); 2) amounts owed on other credit accounts (30% of score); 3) length of credit history (15% of score); 4) frequency of new credit, including requests for credit (10% of score); and 5) types of credit outstanding (10% of score).

Interestingly, the formula does not weigh in any of the categories a factor that was heretofore the crux of credit underwriting decisions; the amount of a consumer's income. As the AT & T representative stated in the bankruptcy court below, "the FICO score does not consider income as a factor because the income is not normally reported on the credit bureau...." Mercer, 220 B.R. at 320.

This produces some curious results. For example, since approximately 30% of an individual's score is based on the amount owed on other credit accounts, one might reasonably assume that if this inquiry is designed to identify individuals who may be over-extended, an individual's income must be considered as part of a debt-to-income ratio. But the FICO score evaluation is not based on a comparison between the consumer's debt burden and amount of income.<sup>5</sup> Given the limitations of credit bureau information, the scoring system does not consider a consumer's total monthly debt service for all obligations, including ongoing household expenses.

Similarly, the highest score component relates to payment history, which primarily tracks late payments. Since there is no correlation with the amount of debt outstanding, consumers making timely minimum payments on credit card

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<sup>5</sup> A recent study concluded that the most "crucial determinant of delinquency" of credit card debt is a household's debt burden. Households whose debt-to-income ratio was 1 percentage point higher than average were approximately 10 percent more likely to have been delinquent. Sandra E. Black and Donald P. Morgan, Meet the New Borrowers, Current Issues, Federal Reserve Board of New York, Vol. 5, No. 3, Feb, 1999.

accounts, even though clearly over-extended or beyond their expense budget, would nevertheless score highly in this category.

More importantly, the final score assigned to a consumer is only as reliable as the information in the credit bureau's data banks. Several studies report that anywhere from 33% to 70% of consumer reports contain mistakes of some kind.<sup>6</sup> In addition, the system can and does break down when creditors fail to supply the necessary updated information on their customers. In re Akins, 235 B.R.866, 874 (Bankr.W.D.Tex. 1999)(until card companies begin reporting "accurate, relevant, and complete information ..., FICO scores will, in large part, continue to be Alice in Wonderland fiction").

*Amicus* does not dispute that the FICO scoring system is a highly sophisticated system for predicting credit risk over a large group of credit profiles. Based on probabilities of risk spread out over hundreds of thousands of customers, it may be a reliable instrument. But in individual cases where it has failed to predict default, those where non-dischargeability is subsequently litigated in a bankruptcy matter, a pre-screening process where a lender never obtains individualized financial information on a debtor simply is not actual reliance on

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<sup>6</sup> Summaries of these studies can be found in National Consumer Law Center Credit and Sales Legal Practice Series, Fair Credit Reporting Act, § 9.2.1 (4<sup>th</sup> Edit.).

any representations of the debtor that would exist had the lender performed a basic credit check.

As card companies compete for market share <sup>7</sup>, the pre-screening attributes they deem acceptable appear less to do with creditworthiness than with identifying consumers who will incur finance charges by carrying credit balances from month-to-month. Credit card usage has grown fastest in recent years among debtors with the lowest incomes. <sup>8</sup> Even solicitation of college students has intensified in recent years. Credit cards are available at many colleges to almost any student -- no income, no credit history and no parental signature required. <sup>9</sup>

While it may be “more efficient” and “more profitable” for credit card companies to rely on pre-screening and FICO scores in making marketing choices,

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<sup>7</sup> From 1994 through 1996, card issuers mailed more than two and a half billion card solicitations each year. In 1997, mailed credit card solicitations jumped by 20% to three billion. Solicitations Reach 3 Billion, but Response Falls, Credit Card News (April 1, 1998).

<sup>8</sup> Since the early 1990s, Americans with incomes below the poverty level have nearly doubled their credit card usage, and those in the \$10,000-25,000 income bracket have come in a close second in the rise in debt. More than one family in nine pays more than 40% of its income on debt service. At income levels below \$25,000, this number rises to one in six. See Family Finances in the United States: Recent Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, p. 1, 21 at Table 14 (Jan. 1997).

<sup>9</sup> Report of the National Bankruptcy Review Commission, 93 (Oct. 20, 1997); George M. Salem and Aaron C. Clark, GKM Banking Industry Report, Bank Credit Cards: Loan Loss Risks are Growing, p. 9 (June 11, 1996); Ellingsworth, 212 B.R. at 331 (“not unusual for college students with no income at all to accumulate 10 to 15 cards while in college”).

Ellingsworth, 212 B.R. at 331-32 <sup>10</sup>, it simply cannot be a substitute for a credit check that any other lender would reasonably conduct. One need only review the facts of several reported decisions to appreciate the severe inadequacies of these systems as probative tools in assessing creditworthiness in the customary sense. <sup>11</sup>

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<sup>10</sup> As noted in Ellingsworth, “one scholar has demonstrated that credit card operations are so much more profitable than other banking areas that lenders can relax their usual lending requirements, suffer a higher default rate, and still be money ahead.” See Ellingsworth, 212 B.R. at 332, *citing* Lawrence M. Ausubel, Credit Card Defaults, Credit Card Profits, and Bankruptcy, 71 Am.Bankr.L.J. 247, 257-64 (1997). As bankruptcy levels have risen, total credit card profitability has grown – credit card lending is now twice as profitable as all other lending activities. In the third quarter of 1997, credit card banks showed a 2.59% return on assets, compared to a 1.22% return on assets reported by all commercial banks. See Federal Reserve Board, The Profitability of Credit Card Operations of Depository Institutions (Aug. 1997); Ausubel, Credit Card Profits, *supra*.

<sup>11</sup> See, e.g., Ellingsworth, 212 B.R. 326, *supra* (Debtor sent a pre-approved credit card with credit limit of \$4,000 based on her FICO score of 759 even though she had 16 other credit cards); In re Feld, 203 B.R. 360 (Bankr.E.D.Pa. 1996)(Debtor issued a credit card with limit of \$7,700 at time she had been receiving disability income and had earned \$9,000 - \$9,500 in prior two years); In re Akins, 235 B.R. 866 (W.D.Tex. 1999)(Debtor obtained approval to use a convenience check up to her full \$4,000 credit limit based on acceptable FICO score even though she had two other credit cards totaling approximately \$30,000 in debt, or 150% of her gross income); In re Briese, 196 B.R. 440 (Bankr.W.D. Wis. 1996)(Debtors issued a pre-approved credit card with line of \$11,500, even though bank had conducted a credit check that confirmed debtors’ unsecured debt alone exceeded 2/3 of their annual income, a debt-to-income ratio of 66%); In re Ward, 857 F.2d 1082 (6<sup>th</sup> Cir. 1988)(Debtor sent pre-approved credit card with \$2,000 credit limit without lender requesting financial statement from debtor or conducting credit check, which would have revealed that debtor had at least twelve other credit accounts and an embezzlement conviction ordering restitution of \$250,000).

These cases suggest that card companies have made a calculated business decision that use of pre-screening lists and FICO scores, primarily as a marketing tool, is simply far more expedient than conducting actual credit checks. As the court in In re Walters, 208 B.R. 651 (Bankr.W.D.La. 1997) observed:

Until such time as the losses attributable to bankruptcy approach or exceed the cost of determining creditworthiness at time of issuance, the court believes issuers will continue to issue pre-approved cards without any inquiry into the cardholder's ability to repay the charges to be incurred by use of the card. The losses they sustain are merely part of their inventory, just as fresh vegetables are to the grocer—each realizes that part of their inventory will be lost, the grocer to spoilage and the card issuer to bankruptcy. Recognizing this inevitability, each makes sure the price they charge will more than make up for such loss in order to attain the anticipated level of profit.

Walters, 208 B.R. at 654.

It may be a perfectly rational business decision for card lenders to issue pre-approved cards without obtaining any individualized credit information on applicants, but lenders who make such business decisions should not then claim that they have relied on any representations of consumers in making their underwriting decisions.

**B. This Court Need Not Reach The Question Of Whether Reliance Was Justifiable In This Case, As The Appellant Has Not Proven That There Was Actual Reliance.**

To prevail on a claim of misrepresentation or fraud under § 523(a)(2)(A), a creditor must initially prove that there has been some *actual* reliance or reliance in fact on representations made by the debtor. Field v. Mans, 516 U.S. 59, 70 (1995)(“If Congress really had wished to bar discharge to a debtor who made unintentional and wholly immaterial misrepresentations having no effect on a creditor’s decision, it could have provided that.”). Courts need not even address the question of whether purported reliance was justified where there has not been an adequate showing that the lender actually relied upon anything emanating from the debtor. In re Hernandez, 208 B.R. 872, 877 (Bankr.N.D.Tex. 1997)(“the *sine qua non* of all reliance claims is reliance in fact.”); In re Akdogan, 204 B.R. 90, 97 (Bankr.E.D.N.Y. 1997)(“[creditor] has burden of proving it *actually* relied on Debtor’s alleged misrepresentation”); In re McDaniel, 202 B.R. 74, 78 (Bankr.N.D.Tex. 1996).

Noting that the concept of reasonableness is not irrelevant in § 523(a)(2)(A) actions even where a justifiable reliance standard is used, the Supreme Court stated: “...the greater the distance between the reliance claimed and the limits of the reasonable, the greater the doubt about reliance in fact.” Field, 516 U.S. at 74, *see also*, Matter of Allison, 960 F.2d 481, 485 (5<sup>th</sup> Cir. 1992)(though justifiable

reliance is required under § 523(a)(2)(a), the “reasonableness of reliance is strong circumstantial evidence in the factual determination regarding actual reliance, which is an element of subparagraph (A).”); In re Walters, 208 B.R. 651, 654 (Bankr.W.D.La. 1997)(Field notes reasonableness still relevant under § 523(a)(2)(A)).

Actual reliance in relation to a claim of false representations or fraud inserts into the common law element the concept of causation. In re Smith, 133 B.R. 800, 806 (Bankr.N.D.Tex. 1991)(“Actual reliance is a causation-type element in a fraud claim. If a party does not rely on a fraudulent representation, the representation cannot be said to have produced an injury to be remedied.”). Simply put, if the alleged misrepresentation does not cause the lender to extend the credit in question, then there can be no reliance.

In the case of pre-approved credit cards, to the extent that the lender is completely indifferent to any matters related to the debtor’s creditworthiness other than information it has obtained on its own through the use of a FICO score and a pre-screening process, there cannot be any reliance in fact on any representations made or implied by the debtor. Walters, 208 B.R. at 654 (no evidence of reliance of any kind).

The reported cases reveal a trend unique to credit card dischargeability cases; the plaintiffs typically present no evidence at all on the reliance element

despite having the burden of proof. *See, e.g., In re Haywood*, 208 B.R. 651, 654 (Bankr.W.D.La. 1997). While many courts have found this perplexing, *e.g., In re Simos*, 209 B.R. 188, 194 (Bankr.M.D.N.C. 1997)(“not clear why no such evidence was offered in this case”), the simple answer is that the credit card industry operates with sole reliance on third-party credit scoring and screening mechanisms, but not on any representations made directly by consumers. The only representations made by consumers, if at all, concern identifying information, such as name and social security number, which are used by card companies solely to verify that the consumer responding to the unsolicited offer is in fact the same consumer on the pre-screening list provided by the credit bureau.

That card companies typically do not place any actual reliance on these representations is made obvious by the examples in the caselaw where such companies have made patently irresponsible lending decisions in the face of “red flags” that truly test the “limits of the reasonable.” *Field*, 526 U.S. at 76 (“...reasonableness goes to the probability of actual reliance.”). Where a debtor responds to a pre-approved credit offer by listing his employment as “Student (New York University)”, *In re Cacciatore*, 209 B.R. 609, 611 (Bankr. E.D. N.Y. 1997), *rev’d and remanded* 1998 U.S. Dist. LEXIS 11246, where a debtor identifies her employer as “self-housewife”, *In re Leonard*, 158 B.R. 839, 841 (Bankr.D.Colo. 1993), where a debtor informs a lender that she is an addicted

gambler and that her account should be closed and the lender subsequently reopens the account based on the debtor's request for an emergency cash advance, In re Crutcher, 215 B.R. 696 (Bankr.W.D.Tenn. 1997), or where a debtor receives a solicitation for a pre-approved card *after filing bankruptcy* and one week before trial in a non-dischargeability action brought by the same lender, In re Hunter, 210 B.R. 212 (Bankr.M.D.Fla. 1997), clearly no reliance whatsoever exists.<sup>12</sup>

Card companies' claims of reliance become even more attenuated where they do conduct some limited investigation based on their own predictive risk models in the pre-screening process before issuing credit cards. As stated in Prosser on Torts: "If, after hearing the defendant's words, he makes an investigation of his own, and acts upon the basis of the information so obtained, he may be found not to have relied on the defendant...." *Prosser on Torts* (4<sup>th</sup> ed.), p. 714 (*footnotes omitted*); *see also*, 37 Am.Jur.2d 306, Fraud and Deceit, § 230:

One is not entitled to relief on the ground of false representations where, instead of relying upon them, he relies upon his own knowledge or resorts to other means of knowledge, as, for example, where he relies on his own judgment or investigations, on his own examination of the property involved, on the advice of other persons, or on information obtained from them.

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<sup>12</sup> It is hard to conceive of any reliance at all by some credit card companies when, as noted by one bankruptcy judge based on local news reports, "a number of functionally-disabled, mentally-impaired persons living in a group home received pre-approved credit cards and had run up significant debts (\$4,000 or \$5,000) before care givers ... explained to the recipients that this was not ... free." In re Reid, 237 B.R. 577, 587, f.n.12 (Bankr.W.D.N.Y. 1999).

In this case, the bankruptcy court and the panel majority correctly concluded that AT &T based its decision to issue Ms. Mercer a credit card not on any financial information she provided but on “a screening formula based on a report of a history of Mercer’s ability to make at least minimum monthly payments on her other credit cards in the past.” Mercer, 211 F.3d at 220. No actual reliance can be found as AT & T relied in fact upon information obtained from a third-party credit bureau and on its “own judgment and experience.” *Id.*

Judge Barksdale in his dissent suggests that AT & T did possess information about Ms. Mercer’s ability to pay when it issued her a card and he questions Judge Dennis’ statement that the credit bureau information obtained by AT & T “included no information as to Mercer’s current financial condition, solvency or ability to repay the loans contemplated.” Mercer, 211 F.3d at 228. However, Judge Dennis’ rendition of the factual record in this case is consistent with the industry practice on pre-screening and the requirements of the Fair Credit Reporting Act in that no direct information bearing on an applicant’s actual credit experience with other lenders can be released to the lender before an offer is accepted. *See* 15 U.S.C. § 1681b(c)(2). In the pre-screening process, lenders such as AT & T are analyzing credit bureau characteristics rather than actual individuals.

**C. The Appellant’s Reliance, If It Relied At All, Was Not Justifiable.**

Even if AT &T could prove that it relied upon some representations made by Ms. Mercer, such reliance was not justifiable under the circumstances. While the justifiable reliance standard generally may not be as exacting as reasonable reliance, its subjective application does not benefit the Appellant here. What may prove justifiable to an uneducated individual not familiar with financial transactions may not be so to a sophisticated financial institution. Even under a justifiable reliance standard, “one who has special knowledge, experience and competence may not be permitted to rely upon statements for which the ordinary man might recover....” *Prosser and Keeton On The Law Of Torts*, § 108, at 751 (5<sup>th</sup> ed. 1984). Ultimately, the question of justification turns on the “qualities and characteristics of the particular plaintiff....” *Field*, 516 U.S. at 71, *citing*, *Restatement (Second) of Torts* (1976), § 545A, Comment *b*.

Judge Barksdale in his dissent suggests that *Field* does not necessarily require that card lenders obtain financial information on a debtor before issuing a card, as the justifiable reliance standard “does not require an investigation.” *Mercer*, 211 F.3d at 227. This ignores, however, the special knowledge and experience that card lenders possess, which *Field* and courts applying the justifiable standard note must be considered. For example, in a case cited with approval in *Field*, the Ninth Circuit in *In re Kirsh*, 973 F.2d 1454 (9<sup>th</sup> Cir. 1992)

found that an attorney did not justifiably rely on a false representation that property that was to serve as security for a loan was unencumbered:

[The attorney] was no ordinary person. In fact, he was not even an ordinary attorney. He had been practicing for twenty years and concentrated on business law. He was well aware of the fact that standard practice in California was for lenders to obtain title reports. Lenders do not merely rely upon the representations of borrowers. That is especially true when the borrower is having financial difficulties and does not always pay his bills in a timely fashion. . . . Obtaining a title report is a simple and not overly expensive proposition. A person with [the attorney's] knowledge, experience and competence should have ordered one.

Kirsh, 973 F.2d at 1461. <sup>13</sup>

Card lenders such as AT & T are sophisticated creditors that have scientific devices at their disposal to forecast creditworthiness and possible fraud, yet typically do not conduct a basic, due diligence credit check that all other lenders perform. But for the question of efficiencies and profits, these financial institutions have the means and acumen to make highly selective underwriting determinations. Their liberal granting of credit to customers who are at best

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<sup>13</sup> One of the most significant factors in finding justifiable reliance in § 523(a)(2)(A) cases has been the personal relationship between the parties. As stated in Kirsh, a “typical case of justifiable reliance” involves the situation where a “lender simply relied upon the honesty of an old friend, who took advantage of him.” Kirsh, 973 F.2d at 1460; *see also*, Sanford Instit. For Savings v. Gallo, 156 F.3d 71, 75 (1<sup>st</sup> Cir. 1998)(lender that did not conduct title search justifiably relied upon debtors’ representations of the property title because of its “extensive and trustworthy” relationship with the debtor); In re Phillips, 804 F.2d 930 (6<sup>th</sup> Cir. 1986). In credit card cases, no such personal relationship generally exists that card lenders may rely upon.

marginally creditworthy does not stem from ignorance or lack of sophistication.

Card lenders simply are not “naifs” in the world of consumer lending: “Naifs may recover, at common law and in bankruptcy, but lots of creditors are not at all naïf ve.

The subjectiveness of justifiability cuts both ways....” Field, 516 U.S. at 76. <sup>14</sup>

Lenders also cannot ignore obvious signs or “red-flags” that would cause them to question their own decisions to grant credit, particularly when such cautionary information is readily at their disposal or could easily be discovered.

As the Field Court stated, a plaintiff is “required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation.” Field, 516 U.S. at 71, *citing* Restatement (Second) of Torts (1976), § 541, Comment *a*.

Even a “cursory examination” in this case, a simple review of the debtor’s credit report, would have revealed that Ms. Mercer was heavily over-extended with other credit card debt. Even less burdensome, had AT & T simply requested that

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<sup>14</sup> Despite this sophistication, it is often not until a debtor is unable to make the minimum payments on a credit card account and seeks relief in bankruptcy that a card company initiates a thorough investigation of the debtor’s financial situation so as to arm itself in a non-dischargeability action:

At this point, the credit card marketing team abruptly ends its relationship with the consumer and the legal team takes over. It is only then that the card companies make their first meaningful investigation into a debtor’s financial condition.

In re Chincilla, 202 B.R. 1010, 1017 (Bankr. S.D.Fl. 1996).

Ms. Mercer state the amount of her outstanding debt in her credit application, a question found on all credit applications except in the credit card arena, it would have alerted AT & T to the debtor's questionable creditworthiness (or laid the groundwork for a § 523(a)(2)(A) action were it not answered truthfully). As noted in Ellingsworth, where a debtor receives a FICO score acceptable to the lender at a time when her expenses exceed her income by at least \$500, this is the "equivalent of buying a horse with one eye." Ellingsworth, 212 B.R. at 339.

Judge Barksdale in his dissent suggests that AT & T was justified in relying on the information it had obtained and had no duty to investigate further because this information raised no "red flag." Mercer, 211 F.3d at 228. This is not surprising given that AT & T obtained nothing of significance from the debtor directly. By asking no questions of the debtor about her financial condition, AT & T can conveniently claim that there were no "red flags" upon which it impermissibly relied.

Card companies request the barest of information about debtors before extending credit; typically the application requests only that the debtor provide a social security number, date of birth, home phone number, employer, employer's address, business phone number and (occasionally) the debtor's annual income. Apart from any business justification for such minimal inquiry based on operating efficiencies, such a practice has been demonstrated in the reported decisions to

facilitate a claim of “plausible denial” in dischargeability litigation. *See, e.g. Cacciatore*, 209 at 616.

Such gaming of the system should not be deemed to meet the justifiable reliance standard; a lender should not be permitted to insulate itself from potential “red flags” by simply never asking necessary and basic questions about creditworthiness.<sup>15</sup> By irrationally limiting their field of view to factors that predict profitability (consumers who make minimum payments) in place of creditworthiness, such lenders should not be rewarded for purposely sticking their heads in the sand so as to ignore or not to be confronted with “red flags” that all other lenders would absolutely and reasonably consider. Otherwise, this would create the perverse result that card lenders who do no credit screening at all would fair better in dischargeability litigation than lenders who responsibly undertake credit investigations.

**II. THE PLAINTIFF HAS FAILED TO PROVE THE DEBTOR MADE FALSE REPRESENTATIONS OR COMMITTED ACTUAL FRAUD WITHIN THE MEANING OF § 523(a)(2)(A).**

**A. The Use Of A Credit Card Does Not Create An Implied Representation Of An Ability To Repay.**

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<sup>15</sup> *See* H.R. Rep. No. 95-595, pp. 130-131 (1977), quoted in *Field*, 516 U.S. at 74, f.n. 13, for a discussion of other techniques creditors have used to create a basis for dischargeability litigation.

*Amicus* respectfully urges this Court to affirm the full panel opinion on the issue that no implied representation of ability to repay is associated with the use of a credit card. As Judge Barksdale stated in his dissent, such a representation would be a statement regarding a debtor's financial condition that is not covered by § 523(a)(2)(A). Mercer, 211 F.3d at 226; *see also In re Anastas*, 94 F.3d 1280, 1285-86 (9<sup>th</sup> Cir. 1996).

As Judge Clark aptly observed in Hernandez, it would be ironic for card lenders to succeed with an implied representation of ability to repay theory given the nature of the credit card transaction:

One of the primary reasons people use credit cards, after all, is a present *lack* of ability to repay .... More importantly, *the* primary reason creditors want customers to use their credit card is that very inability of their customers to timely repay their credit card debt ....

\* \* \*

More to the point, adoption of this theory also improperly shifts the burden of proof ..., renders nugatory the principle that exceptions to discharge are to be construed strictly against the objecting creditor and liberally in favor of the debtor ..., and leads to the creation of an incredible irony; an ability to repay is inferred to protect an industry that purposefully solicits customers who generally lack such ability. It is not the job of any court, however, to *infer* added protection for the benefit of one industry.

Hernandez, 208 B.R. at 879-80 (*citations omitted, emphasis in original*).

In addition, most courts that have found the use of a card to be an implied representation of ability to pay have failed to consider the analogous situation involving the passing of a bad check. In this context, the Supreme Court has found that the issuance of a check is not an implied representation that the payor has sufficient funds to cover the check in the account. Williams v. United States, 458 U.S. 279, 284, 73 L.Ed. 2d 767, 102 S.Ct. 3088 (1982) (“Technically speaking, a check is not a factual assertion at all, and therefore cannot be characterized as ‘true’ or ‘false.’”). Given the similarities between the writing of a check and the use of a credit card, the Alvi court was correct in concluding that it would be “illogical” to find that the use of card involves a representation “when the issuance of a bad check does not.” Alvi, 191 B.R. at 732, *see also*, In re Kuntz, 249 B.R. 699, 705-06 (Bankr.N.D.Tx. 2000).

**B. An Implied Representation Of Intent To Repay Cannot Be A Substitute For Proof Of Fraudulent Intent.**

To the extent that use of a credit card implies a representation of an intention to repay, it proves very little in a § 523(a)(2)(A) action. There is no need to imply a representation that simply mirrors the terms of the cardholder agreement, which typically contain an express promise to repay. In re Cox, 182 B.R. 626, 636 (Bankr.D.Mass. 1995). Ultimately, the plaintiff must still prove all of the elements

of common law fraud.<sup>16</sup> Mercer, 211 F.3d 219 (Judge Dennis’ concurring opinion); Field, 516 U.S. at 70 (“false pretenses, a false representation, or actual fraud’ ... are common law terms, and ,...they imply elements that the common law has defined them to include.”).

Collier describes the “actual fraud” requirement in § 523(a)(2)(A) as follows:

Actual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another –something said, done or omitted with the design of perpetrating what is known to be a cheat or deception.

*Collier on Bankruptcy*, ¶ 523.08[1][e] (15<sup>th</sup> rev’d ed. 1989).

Even as to claims of false pretenses and false representations, this Court has held that the misrepresentations must involve “knowing and fraudulent falsehoods.” Allison, 960 F.2d at 483. In such cases, this Court has made clear that creditors may not rely on implied fraud: “Section 523(a)(2)(A) contemplates frauds involving ‘moral turpitude or intentional wrong; fraud implied in law which may exist without imputation of bad faith or immorality, is insufficient.’” *Id.* at

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<sup>16</sup> Though this Court has described slightly different elements for “false pretenses and false representation” claims than for “actual fraud” claims under § 523 (a)(2)(A), both claims require as a common element a showing of a knowing and false representation. RecoverEdge L.P. v. Pentecost, 44 F.3d 1284, 1293-94 (5<sup>th</sup> Cir. 1995).

483, quoting, *Collier on Bankruptcy*, ¶ 523.08[4] (15<sup>th</sup> ed. 1989)(currently found at ¶ 523.08[1][d]).

In RecoverEdge, this Court further commented that the phrase “actual fraud” was added to the fraud discharge exception with the enactment of the Bankruptcy Code in 1978, and referenced the commentary in *Collier on Bankruptcy* suggesting that the addition “simply clarifies the limited scope of the fraud exception”:

The addition of the words "or actual fraud" probably makes no change in the law as it existed prior to enactment of the [Bankruptcy Act of 1978] because false pretenses and representations were construed to mean acts involving moral turpitude or intentional wrong....In any event, section 523(a)(2)(A) was intended to codify case law as expressed in *Neal v. Clark*, [95 U.S. 704, 24 L.Ed. 586 (1877)], which interpreted "fraud" to mean actual or positive fraud rather than fraud implied by law. 3 *Collier on Bankruptcy* ¶ 523.08[5], at 523-58 (footnotes omitted).

RecoverEdge, 44 F.3d at 1293, f.n.16.

*Amicus*' concern with the implied representation of intent to repay is that it is often presented as having a larger significance than is warranted; to imply fraud where no actual fraud exists. In many § 523 actions, the crux of the card company's argument is that by using a card at a time when the debtor was “hopelessly insolvent”, a court may somehow infer that this was a knowing and intentional misrepresentation of intent to repay or an intentional act to defraud the lender. Such inferences based on the financial

condition of the debtor do not satisfy the actual fraud requirement of the statute.<sup>17</sup>

In Neal v. Clark, the decision cited with approval in the legislative history of current § 523(a)(2)(A)<sup>18</sup>, the Supreme Court noted that it is exactly the hopelessly insolvent debtor that Congress intended to protect with the bankruptcy laws:

... the ‘fraud’ referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality. Such a construction of the statute is consonant with equity, and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency. A different construction would be inconsistent with the liberal spirit which pervades the entire bankruptcy system.

Neal v. Clark, 95 U.S. at 709.

More to the point, card companies should not gain an advantage in § 523 litigation based on the status many debtors in bankruptcy find themselves as a direct result of card companies’ own policies. Card companies’ reliance on credit

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<sup>17</sup> If there are to be any presumptions in § 523 actions, these should run in favor of the debtor. The Supreme Court has stated that “the law presumes, in the absence of evidence to the contrary, that the business transactions of every one are carried on in good faith, and any one who alleges that such acts are done in bad faith, or for a dishonest and fraudulent purpose, takes upon himself the business of showing the same.” Jones v. Simpson, 116 U.S. 609, 615, 6 S.Ct. 538, 29 L.Ed. 742 (1886). Fraud, on the other hand, is “never presumed; and where it is alleged the facts sustaining it must be clearly made out.” Farar v. Churchill, 135 U.S. 609, 615, 10 S.Ct. 771, 34 L.Ed. 246 (1890).

<sup>18</sup> See 124 Cong. Rec. H11, 095-6 (daily ed. Sept. 28, 1978); S17, 412-13 (daily ed. Oct. 6, 1978).

scoring tools that identify potential customers who have a higher probability of making minimum payments certainly serves their purpose well. Contrary to customary notions of creditworthiness, card companies do not want customers who have shown an ability to pay their other accounts in full each month. Ellingsworth, 212 B.R. at 339. From a profitability standpoint, this undoubtedly makes good business sense.<sup>19</sup> One national credit card company, as noted in In re Hernandez, 208 B.R. 872, 879 (Bankr.W.D.Tex. 1997), earns \$318 per year on the average customer who carries a balance, while it loses \$30 per year on customers who pay off their balances each month.

But credit card companies should not then turn around, after rewarding customers having proven minimum payment histories with additional credit and special offerings,<sup>20</sup> and claim that these same customers were using their cards at a time when they were “hopelessly insolvent.” It is such companies’ own policies regarding minimum payments, teaser rates, convenience checks, and cash advances (even at gambling casinos) that encourage customers to spiral further into debt and

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<sup>19</sup> Credit card issuers earn about 75% of their revenues from the interest paid by borrowers who do not pay in full each month. David S. Evans & Richard L. Schmalensee, The Economics of the Payment Card Industry, Fig. 3 (1993).

<sup>20</sup> When asked why a credit card company would offer a card to a customer who already has five cards, Charles Albright, vice president of Household International, stated in testimony before the National Bankruptcy Review Commission that: “The strategy employed is an attempt to gain market share and replace one of the credit cards in the consumer’s wallet today.” Testimony reprinted in *Credit*, Jan/Feb. 1997.

become hopelessly behind.<sup>21</sup> To further exacerbate the problem, card lenders typically respond to consumers who show signs of financial trouble by increasing their credit limits. *See, e.g. In re Burge*, 198 B.R. 773, 775 (9<sup>th</sup> Cir. BAP 1996); *McDaniel*, 202 B.R. at 76; *Chincilla*, 202 B.R. at 1015. Certainly, a lender that has a history of taking such steps, or failing to terminate credit in such situations, cannot claim that it has actually and justifiably relied upon its customers' payment histories. Once again, any other result would create a perverse incentive for card lenders to never monitor consumers' use of credit, so as not to encounter "red flags", and thereby improve their position in dischargeability litigation over lenders that do responsibly monitor usage.

*Amicus* respectfully urges this court to adopt a dischargeability standard in credit card cases that does not place an undue emphasis on factors not directly probative of a debtor's fraudulent or malicious intent. As the Ninth Circuit has stated in *Anastas*, the "... the hopeless state of a debtor's financial condition should never be a substitute for an actual finding of bad faith:"

Thus, the focus should not be on whether the debtor was hopelessly insolvent at the time he made the credit card charges. A person on the verge of bankruptcy may have been brought to that point by a series of unwise financial choices, such as spending beyond his means, and if

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<sup>21</sup> Minimum payments are often set at an amount that does not even cover the monthly finance charges. The court in *Chincilla*, 202 B.R. at 1016 noted by way of example that in a billing period shortly prior to his voluntary cancellation of his card, Mr. Chincilla made a required minimum payment of \$78, but incurred \$92.14 in interest charges.

ability to repay were the focus of the fraud inquiry, too often would there be an unfounded judgment of non-dischargeability of credit card debt. Rather, the express focus must be solely on whether the debtor incurred credit card debt with the intention of petitioning for bankruptcy and avoiding the debt.

Anastas, 94 F.3d at 1286.

**C. Policy Considerations In This Case Do Not Favor A Weakening Of The Dischargeability Standard.**

It has been said that the card industry's lending practices have resulted in a "democratization" of credit. Current Issues, FRB of New York, *supra*, at 1; Ausubel, Credit Card Debts, *supra*. The clear result of this democratization is an increase in defaults and resulting bankruptcies. Chincilla, 202 B.R. at 1016, f.n.5 ("part of the price of this freedom to borrow is the marked rise in consumer bankruptcy filings correlated closely with this 'democratization'"). In response, credit card lenders, such as AT & T in this case, have sought a weakening of the fraud standard (or legislative changes).

Referring to the losses card companies experience because of consumer bankruptcies, Judge Barksdale in his dissent suggests that an application of § 523 that is more accommodating to lenders should be adopted. The problem with this policy justification for a pro-lender approach is that there is no evidence that it will alter consumer behavior in any significant manner since, unlike card lenders,

consumers generally do not act based on an awareness of bankruptcy law or the nuances of dischargeability standards. On the other hand, one commentator has suggested that a liberalizing of the fraud standard would actually have the opposite effect since card companies would likely “increase the pace of credit card solicitations and credit line expansions, while marginal consumers should not be expected to neutralize the effect by declining the issuers’ offers.” Ausubel, Credit Card Debts, *supra*, at 269.

To the extent that this Court considers the policy implications of its decision in this matter, *amicus* urges it to adopt the position of Judge Duhe that requiring lenders to clearly satisfy the burden of proof in § 523(a)(2)(A) cases “will hopefully encourage more responsible lending practices by credit card issuers.” Mercer, 211 F.3d at 218.

## CONCLUSION

For all the foregoing reasons, *amicus* respectfully requests that the majority panel opinion be affirmed.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that I served both a paper copy and a 3.5 inch diskette containing an electronic version of this *Amicus Curiae* Brief of the National Association of Consumer Bankruptcy Attorneys by U.S. mail, postage prepaid, on this 8<sup>th</sup> day of September, 2000 to counsel for all parties at the following addresses:

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## CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C) and 5<sup>th</sup> Cir. R. 32.3, the undersigned counsel certifies that this amicus brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) and 5<sup>th</sup> Cir. R. 32.1.

1. Exclusive of the portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii), this brief contains 6,957 words printed in a proportionally spaced typeface.
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4. The undersigned counsel understands that a material representation in completing this certificate, or circumvention of the type-volume limits in Fed. R. App. P. 32(a)(7)(B), may result in the Court's striking this brief and imposing sanctions against the person who signed it.

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