CONSUMER BANKRUPTCY

Discharging Christmas gift purchases in bankruptcy

Unusually entertaining decision teaches valuable lesson

By Craig D. Robins

Bankruptcy attorneys often get busy towards the end of Jan. each year as consumers, having just finished their family holiday obligations, receive a new round of ever-increasing credit card bills, compelling them to seek bankruptcy advice.

Of course, many of these bills contain charges for holiday gift purchases made just weeks before. An interesting, and most unusual opinion from 1992, which I found most entertaining for a bankruptcy court decision, addressed this very issue. *In re Johannsen*, 160 B.R. 328 (Bkrtcy. W.D.Wis. 1992).

However, as unusual as this decision is, its importance to us today really has nothing to do with the atypical subject matter. To me, the real lesson to be learned from this case is that no matter how sure you are of being successful with litigation, you can still end up losing what appears to be a slam-dunk case.

To further pique your interest, let me quote some of the wording from the published opinion:

> "[s]he's short and buxom with a tiny waist and remarkably long legs which — despite her age (34) — are cellulite free."

This is not the typical verbiage we usually see in judicial decisions. But here, the judge is talking about Barbie, the iconic plastic doll manufactured by Mattel, and a perennially favorite gift to young girls everywhere.

The debtor in this case, a woman who filed Chapter 7 jointly with her husband even though they were in the process of divorce, bought some Barbie dolls from Sears for her daughter, 7, intending them to be Christmas presents. Shortly thereafter, the debtor filed for Chapter 7 relief, seeking to discharge various debts including her Sears credit card debt.

The debtor had made several purchases including Barbie and Ken items, a Barbie case, a Barbie armoire, and an extensive wardrobe of Barbie clothes. The purchases totaled $1,100. That's a lot of Barbie toys! All of these purchases were made in the five weeks prior to filing the bankruptcy petition, including one purchase of $178 which was made a mere two days before the petition was filed.

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Sears then filed an adversary proceeding pursuant to Bankruptcy Code § 523(a)(2)(C), claiming that the debt for these Barbie doll purchases, which the debtor charged on her Sears credit card, should be declared non-dischargeable.

An adversary proceeding contesting dischargeability is essentially a federal lawsuit brought within a bankruptcy. Sears commenced this with a federal summons and complaint, leading to a full-blown trial in which both the debtor and a Sears employee testified. In bankruptcy proceedings, creditors have a few grounds to challenge the dischargeability of a debt, and they must do so by adversary proceeding.

Sears argued that the debts for these purchases should be non-dischargeable under several theories including § 523(a)(2)(A), which prevents discharging a debt if was incurred by false pretenses, and § 523(a)(2)(C), which prevents a debtor from discharging a debt of more than $500 for "luxury goods or services" incurred within 40 days prior to filing. (Note: the dollar amount and number of days in the statute has since changed.)

Sears contended that the Barbie dolls and accessories were not reasonably necessary for the debtor or her daughter's support or maintenance. The Sears employee testified that the Barbie dolls of the type purchased were at the higher end of the price scale of toys sold by Sears.

The debtor testified that some of these purchases consisted of "collector" Barbie dolls. She even introduced the Sears Christmas Catalog as an exhibit. But on cross-examination, the debtor testified that she was just a waitress earning minimum wage and that she had been separated from her husband, and was receiving support and maintenance.

Sears brought to the court's attention that the debtor could have purchased a much less-expensive Barbie doll for just $9.99, but the debtor responded that the collector Barbies were investments which would appreciate in value.

The debtor also testified that her daughter owned a collection of 25 Barbie dolls, to which Sears argued, was proof that the additional Barbies were clearly luxury expenses, as they were not necessary for the daughter's welfare. After all, how many Barbies does a seven-year-old need?

Just gleaning these facts would probably lead any bankruptcy attorney to conclude that the Barbie purchases would certainly be non-dischargeable. The judge even pointed out that these purchases may have been foolish and irresponsible in light of the debtor's financial condition.

However, the judge held that the debt was indeed dischargeable! He stated: "Although this case at first glance appeared to be a classic case for § 523(a)(2)(C)'s luxury goods exception, subsequent investigation and testimony revealed no evidence of such intent in making the relevant purchases."

The judge pointed out that the discharge exception for luxury goods provided a presumption that the debt ought not to be discharged, basically a conclusion that the debtor did not have the intent to pay the debt. However that presumption can be rebutted and the debtor did just that.

Apparently, the debtor was only added to the petition at the last minute, and at the request of divorce counsel. In addition, the judge determined that the debtor, at the time she made the various purchases, had the intent to pay for them, despite her precarious financial circumstances.

Imagine the surprise to Sears' counsel of this highly unexpected result. But that's the lesson. You never know how the court will rule, and being sure of the merits of your case is no guarantee for success.

Although we have some fine trustees in this district, I've found some of them to suffer from myopic vision when evaluating the cases they litigate against consumer debtors. A review of the written decisions from the Eastern District of New York shows numerous instances in which trustees have vigorously litigated, only to lose.

I would suggest a more pragmatic approach involving settlement would have better served both trustee and debtor, alike. This may be especially true when considering the extent that some bankruptcy courts will go, as is the case here, to favorably enable debtors to get a fresh financial start. Hopefully all litigants will become more open-minded to pragmatic approaches towards case resolution.

A full copy of the *Johannsen* decision is available on my blog.

Note: Craig D. Robins, a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past 20 years. He has offices in Coram, Mastic, West Babylon, Patchogue, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: www.BankruptcyCanHelp.com and his Bankruptcy