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CONSUMER BANKRUPTCY

Discharging Gambling Debts: 10 Points to Know

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Gambling has long been a culprit that drives people into bankruptcy. With Atlantic City and Indian casinos a mere bus ride away, Long Islanders are finding it ever so easy to gamble away their hard-earned incomes and get into a bad debt situation. Combine that with horse racing and OTB, lotteries, bookies and now, internet gambling, and we have plenty of opportunities for individuals to lose their shirts. Day trading with stocks is also considered by many to be an addictive form of gambling. It is no secret that compulsive gamblers incur devastating debts on their credit cards to fuel their obsessions.

Gamblers often get trapped in a vicious cycle of taking cash advances for gambling in the hope that future winnings will then satisfy ever-increasing debt. Left unchecked, this cycle will usually drive the gambler into a downward vortex, destroying the gambler and his family financially.

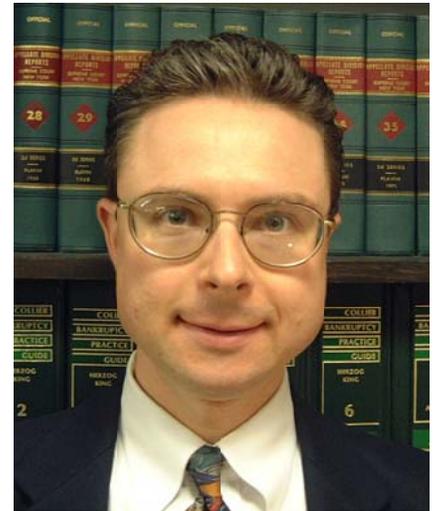
Gamblers may actually have some luck on their side if they can take advantage of the current bankruptcy laws, as the filing of a Chapter 7 bankruptcy will enable the gambler to discharge most gambling debts. It appears that with the surge in legalized gambling across the

country, bankruptcy courts have become more liberal in permitting gamblers to discharge their gambling debts.

However, proposed legislation, if enacted, will certainly make it increasingly more difficult for gamblers to discharge their debts. Such legislation is currently pending and would adversely affect all consumer filings, not just those of gamblers. One commentator suggested that the legislature is suffering from apparent schizophrenia—they are constantly legalizing more gambling, yet condemning the ever-increasing amount of consumer debt and the "ease" of its discharge.

The following are points that the consumer bankruptcy practitioner should be aware of with regard to discharging gambling debts of their clients.

1. Gambling debts are generally dischargeable. There is no statutory authority that expressly states that gambling debts are non-dischargeable. Therefore, gambling debts are not per se non-dischargeable.



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2. A creditor must prevail in an adversary proceeding for a gambling debt to be non-dischargeable. All gambling debts are dischargeable unless a creditor objects to them in an adversary proceeding. Adversary proceedings are federal law suits brought within a bankruptcy. They are involved and costly for all parties. Going back several years, casinos and credit card companies often sought to object to discharging extensions of credit given to debtors at the casino. However, such suits are much less common today.

3. Creditors rely on certain statutory provisions when they allege that gambling debts are non-dischargeable. There is one major Bankruptcy Code provision that creditors generally use in adversary proceedings to

challenge dischargeability of gambling debts. This is Code section 523(a)(2)(A) which provides an exception to discharge for debts obtained by "false pretenses, a false representation, or actual fraud."

4. Creditors have the burden of proof. Although there appear to be fewer creditors today bringing adversary proceedings objecting to gambling debts, some creditors continue to bring such suits. A creditor seeking to object to a debt bears the burden of proof by a preponderance of the evidence as stated by the U.S. Supreme Court in the 1991 *Grogan* case.

5. Creditors must establish four elements. In order for a creditor to prove false pretenses, false representations or fraud, the creditor must generally establish each of four separate elements: **a) false representation** (the creditor must prove that the gambler made a false representation through which the gambler obtained money, such as by lying on a credit application); **b) knowledge** (the creditor must prove that the gambler either knew the representation was false or made with such reckless disregard for the truth as to constitute willful misrepresentations -- this is often the major element that is litigated); **c) scienter** (the creditor must prove that the debtor intended to deceive); and **d) justifiable reliance** (the creditor must show that it actually relied on the gambler's false representation and that creditor's reliance was justifiable).

6. The reasonableness standard: subjective ability to pay has become the general rule. Earlier cases concerning whether debtors believed that they would be able to repay gambling debts focused on whether the debtor's belief was reasonable from an objective viewpoint. The creditor would argue that the debtor "knew or should have known" that the debtor could not possibly pay back his debt.

A debtor will often assert that his only hope of repaying a gambling debt is to win it big in the future. Prior cases held that gambling debts in such situations should be non-dischargeable because the debtor's belief was not reasonable.

However, the current trend has shifted to a more subjective determination. One case held that the debtor's "honest but somewhat questionable belief that he would soon get lucky at gambling and pay off his debts" demonstrated intent to repay. Thus, a debtor may be able to defeat the creditor's position if the debtor can persuade the court that based on his history, the debtor genuinely believed that he would be able to pay his debts and that he had the intent to pay his credit card debts at the time he incurred them.

7. The courts are mindful of public policy arguments. In recent years, this country's policies toward gambling have also shifted for social policy reasons. One Court's position is this: At one point in time, not so far in the past, gambling was against public policy and gambling debts were not enforceable in a court of law. But public policy changed. Certain forms of gambling are now legal They are hyped as a source of jobs (i.e., casinos), as a source of revenue for government (i.e. Lottery proceeds used for education), and as a form of entertainment (i.e., casinos and off-track betting).

8. The luxury goods and cash advance exceptions can make the debt non-dischargeable. Code section 523(a)(2)(C) makes a debt non-dischargeable if it is for a "luxury good or service" over \$1,225 that is purchased within 60 days pre-petition, or if it is a cash advance over \$1,225 obtained within 60 days pre-petition. Problems with these exceptions can be easily avoided by properly questioning your client about their

pre-petition credit use and then waiting the requisite period of time.

9. Beware of pending bankruptcy reform legislation. In some versions of the pending legislation bill, there is language that provides that a debt incurred when the debtor had no reasonable expectation or ability to repay it is non-dischargeable. This would adversely slam the liberal trend in the case law mentioned above. If the bankruptcy laws change, it may become much harder to discharge gambling debts.

10. Gamblers need non-legal help also. Compulsive gamblers suffer from an addiction disorder and need professional help. Although the bankruptcy practitioner can certainly help by providing the opportunity for a fresh new financial start, you should urge the client to seek professional help. In addition to counseling, there are support groups such as Gamblers Anonymous.

Editor's Note (revised 2008): Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. He has offices in Medford, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: CraigRobinsLaw.com.