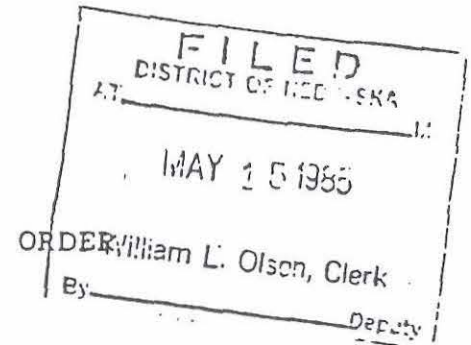


IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

RODNEY FITTS, d/b/a FITTS FEED)
AND JOHNSON FEED STORE,)
)
Debtor.)
)
CENTRAL SOYA COMPANY, INC.,)
)
Plaintiff,)
)
vs.)
)
RODNEY FITTS,)
)
Defendant.)

BK 83-1991
CV 84-0-654



This matter is before the Court upon appeal from an order of the United States Bankruptcy Court for the District of Nebraska. The appellant-creditor, Central Soya Co., appeals from the Bankruptcy Court's September 21, 1984, decision dismissing the appellant's claim alleging that credit was obtained by the appellee-debtor by the use of a false financial statement in violation of 11 U.S.C. § 523(a)(2).

The appellant, a manufacturer of food products and livestock feeds, began to extend credit to the appellee, the owner of a feed store in Gehring, Nebraska, in December of 1981. In a financial statement dated December 8, 1981, the appellee disclosed that he operated his business as a partnership with his wife, that his wife owned a house worth \$33,000.00., and that his net worth was \$62,564.00. This statement was signed by Mr. Fitts. A second financial statement dated April 9, 1982, showed no change in partnership status, still listed the home as an asset, and showed a net worth of \$62,582.00. This statement was signed by both Mr.

and Mrs. Fitts. The appellant states that on the basis of the second financial statement the credit line for the appellee was increased from \$7,500.00 to \$15,000.00 to accommodate increased volume purchases.

A third financial statement dated May 10, 1983, showed no change in partnership status, listed the house as an asset, and disclosed a net worth of \$69,137.00. A fourth financial statement dated May 26, 1983, was the same in all respects as the third, but disclosed a net worth of \$73,577.25. A fifth and final financial statement, submitted on July 5, 1983, showed a net worth of \$74,887.00.

In addition to these financial statements the appellee was also providing profit and loss statements to the appellant. These statements showed the appellee's business to be generally profitable and the appellant continued to extend credit.

In November of 1983, the appellee closed his business and filed bankruptcy. The petition in bankruptcy stated that the appellee's business was a sole proprietorship and that he had a negative net worth of \$49,000.00. The house was not listed as an asset.

Central Soya filed this suit in the United States Bankruptcy Court for the District of Nebraska objecting to the discharge of the indebtedness. The appellant claimed that the appellee fraudulently misrepresented the nature of his business, the ownership of his wife's house, and his net worth in violation of 11 U.S.C. § 523(a)(2), which prohibits untruthfulness in the

furnishing of financial statements. The Bankruptcy Court sustained the appellee's motion to dismiss at the close of appellant's evidence and observed:

The question of the house is important to the plaintiff. It is accurately disclosed as an asset of the wife, and then the question is whether the one indication in the evidence on the financial statement that it was a partnership is somehow sufficient to withstand the motion to dismiss. It is a conclusion and not a factual statement, and to the extent that it is a conclusion, I conclude that it is not something upon which the plaintiff could reasonably rely in extending credit. It is a legal conclusion, nothing more than that, and it would have been quite easy for the plaintiff to have taken a guaranty from the wife to ensure that her assets would be subject to the debts of Mr. Fitts. But I do not believe that the plaintiff was justified in relying upon legal conclusions as to the mode of his doing business.

Transcript at 71-72.

The Bankruptcy Judge's findings of fact are "entitled to stand unless clearly erroneous." In re American Beef Packers, Inc., 457 F. Supp. 313, 314 (D. Neb. 1978). Where there are presented for consideration mixed questions of fact and law, the clearly erroneous rule is not applicable, id., and the Bankruptcy Judge's decision cannot be approved without this Court's independent determination of law. In re Werth, 443 F. Supp. 738, 739 (D. Kansas 1977) (citing Stafos v. Jarvis, 477 F.2d 369, 372 (10th Cir.), cert. denied, 414 U.S. 944 (1973)).

The appellant argues that the Bankruptcy Court erred in finding that the financial statement submitted by the appellee to Central Soya did not fraudulently misrepresent the appellee's financial condition within the meaning of 11 U.S.C. § 523(a)(2).¹

That statute provides:

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

(2) for obtaining money, property, services or an extension, renewal, or refinance of credit, by-- . . .

(B) use of a statement in writing--

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for obtaining such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive;

. . . .

The general rule is that all elements of 523(a)(2)(B) must be proved by clear and convincing evidence. In re Weiss, 42 B.R. 314, 316 (Bankr. E.D. Pa. 1984); In re Russell, 18 B.R. 325, 327 (Bankr. E.D. Pa. 1982); In re Tomeo, 1 B.R. 673, 677 (Bankr. E.D. Pa. 1979).

¹The appellant also argues that the Bankruptcy Court erred in sustaining the debtor's motion to dismiss at the end of plaintiff's case without making specific findings of fact and law as required by Fed. R. Civ. P. 41 and 52(a). The Court finds the Bankruptcy Judge's observations from the bench at the close of the hearing of the plaintiff's claim was sufficient to satisfy Fed. R. Civ. P. 41 and 52(a).

Central Soya contends that the appellee committed fraud by misrepresenting the nature of his business. The first financial statement, dated December 8, 1981, indicated that the appellee had formed a partnership with his wife. The statement also listed a home owned by Mrs. Fitts with a value of \$46,000.00 encumbered \$13,000.00 by a mortgage, resulting in an asset worth \$33,000.00.

In the bankruptcy petition the house was not listed as an asset and the appellee's business was characterized as a sole proprietorship. Central Soya alleges that it relied on this representation and this asset when extending credit to the appellee.

In addressing the alleged misrepresentations involving the partnership, the house, and Central Soya's purported reliance on the house as an asset available as security for appellee's business debt, the Bankruptcy Judge concluded that

it is not something upon which the plaintiff could reasonably rely in extending credit. It is a legal conclusion, nothing more than that, and it would have been quite easy for the plaintiff to have taken a guaranty from the wife to ensure that her assets would be subject to the debts of Mr. Fitts. But I do not believe that the plaintiff was justified in relying upon legal conclusions as to the mode of his doing business.

This Court agrees, in part, with the Bankruptcy Court's analysis. Even if Central Soya relied on the characterization of Mr. Fitts' business as a partnership, there is no indication that chattels, inventory or accounts characterized as business assets were not present at the time the statements were made. And, the financial statements plainly set forth that the house was an asset of one of the general partners, and not of the partnership.

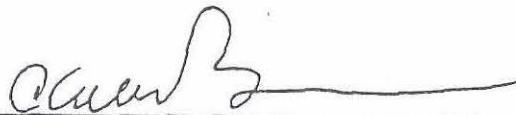
Under these circumstances, sound business practice required Central Soya to make a reasonable effort to check the credit rating beyond reliance upon the statements. Weiss, 42 B.R. at 316; Matter of Stout, 39 B.R. 438, 440-41 (Bankr. D. Mo. 1984). The Court further finds that Central Soya's reliance, if any, on the house of an individual partner, as an asset to secure the indebtedness of Mr. Fitts or a partnership, without more, was not reasonable. See Carini v. Matera, 592 F.2d 378, 381 (7th Cir. 1979) (reliance must be reasonable); Beneficial Financial Co. of Williamantic, 239 A.2d 98, ____ (Conn. 1967).

Therefore, the Court finds that the decision of the Bankruptcy Court should be and hereby is affirmed.

IT IS SO ORDERED.

DATED this 15th day of May, 1985.

BY THE COURT:



C. ARLEN BEAM
UNITED STATES DISTRICT JUDGE