IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

In the Matter of	)	BK 79-0-593
GENE J. ABBOUD,	)	
Bankrupt.	)	
FORT CALHOUN STATE BANK,	)	CIVIL NO. 80-0-79
Plaintiff,	)	
vs	)	MEMORANDUM
GENE J. ABBOUD,	)	
Defendant.	)	

APPEARANCES: For Plaintiff-Appellant - John C. Mitchell, Omaha, Nebraska

For Defendant-Appellee - William E. Pfeiffer, Omaha, Nebraska

DENNEY, District Judge

This matter comes before the Court on appeal from an order of the Bankruptcy Judge discharging the indebtedness due to the plaintiff-appellant, Fort Calhoun State Bank [hereinafter referred to as "Bank"], from the defendant-appellee, Gene J. Abboud [hereinafter referred to as "Abboud"]. The Bank objects to the discharge of the indebtedness pursuant to §17a(2) of the Bankruptcy Act [11 U.S.C. §17a(2)] [hereinafter referred to as the "Act"], on the grounds that Abboud obtained loans from the Bank by making or causing to be made materially false statements in writing reflecting his financial condition.

On December 23, 1974, Abboud obtained a $60,000.00 loan from the Bank. Between the date of that original note and December 15, 1976, the original note was twice renegotiated for smaller amounts as Abboud made efforts to pay off the Bank loan. On each of the three occasions, Abboud gave the Bank financial statements.

On May 18, 1979, Abboud filed a petition in bankruptcy. Subsequently, the Bank initiated an adversary proceeding for a determination that the debt owed by Abboud to it by reason of the third promissory note was undischargeable. Prior to Abboud's filing his bankruptcy petition, the Bank obtained a judgment on the note in state court. Trial was conducted by the Bankruptcy Judge, who found generally in favor of Abboud, dismissed the Bank's complaint with prejudice, and discharged the indebtedness owing to the Bank [Filing #33].

In his memorandum opinion, the Bankruptcy Judge reviewed the case and made several findings of fact [Filing #32]. The first issue of fact concerned Abboud's listing of Bell Janitorial Service as an asset on the financial statements with valuations varying from $56,000.00 to $71,000.00. The Bank claimed that the figures were grossly exaggerated. Abboud was somewhat uncertain and unclear as to the exact method of valuation that was utilized. Testimony revealed that he may have arrived at the valuations by totalling the individual values of various contracts to perform services into which Bell Janitorial had entered. The business was not valued according to its physical assets, apparently due to the service-oriented nature of the business. The Bankruptcy Judge concluded that while Abboud's deposition and testimony at trial would allow him to speculate that the janitorial business had been overvalued on the financial statements, the Bank failed to meet its burden of proof that these figures had, in fact, been exaggerated.

The Bank raised a similar challenge to Abboud's $25,000.00 valuation of household furniture and furnishings. The Bankruptcy Judge again held that the Bank failed to prove that the assets were not in fact worth that much.

The Bank also sought to show that Abboud had listed $10,300.00 interest in a restaurant as an asset on one of the financial statements. In fact, Abboud was only the lessee of equipment which was used in the restaurant operation. The Bankruptcy Judge held that the Bank would not reasonably rely on that asset because prior to renegotiating the note, the Bank had received a more current statement from Abboud on which the restaurant interest was not listed.

The Bank claimed that Abboud failed to disclose on the financial statements loans which the Bank had previously extended to Abboud. The Bankruptcy Judge held that the Bank was under a duty to exercise a minimum of diligence to find out what it had previously done, i.e., the Bank could not "shut its eyes to previous transactions" with Abboud and still claim reliance on an error in the financial statements.

Finally, the Bankruptcy Judge found that the evidence did not support the Bank's assertion that Abboud had undervalued the extent of his liabilities on one of the statements.

The applicable standards of review for this kind of case are well defined. In determining whether a debt is nondischargeable on the ground that the bankrupt obtained money or other property through representations known to be false or made with reckless disregard for truth amounting to willful misrepresentation, issues of knowing or reckless falsehood and intent to deceive are fact questions and the bankruptcy court's findings are conclusive

unless "clearly erroneous." Carini v. Matera, 592 F.2d 378, 380 (7th Cir. 1979). A presumption exists that the findings below were correct. In re Moscolo, 505 F.2d 274, 277 (1st Cir. 1974); see also Solomon v. Northwestern State Bank, 327 F.2d 720, 724 (8th Cir. 1964). A finding by the bankruptcy court is "clearly erroneous" when, although there is evidence to support it, the reviewing court is left with the firm and definite conviction that a mistake has been committed. Bank of Meeker v. McGinnis, 586 F.2d 162, 164 (10th Cir. 1978). The burden of showing that the bankruptcy court's findings were clearly erroneous is a quite stringent one. City Nat'l Bk. v. Knight, 421 F.Supp. 1387, 1390 (M.D. La. 1976), aff'd 551 F.2d 861, 862 (5th Cir. 1977).

At the outset, the Court recognizes that it is well established that the purpose of the Bankruptcy Act is to afford the debtor a new chance in life unburdened by pre-existing debts, and therefore exceptions to discharge should be construed in favor of the bankrupt so far as is reasonable. In re Burton, 4 B.C.D. 569 (B.C. N.Y. 1978). Bankruptcy Rule 407 places the burden of proving facts essential to the objection to discharge upon the plaintiff. BANKR. RULE 407; 1A COLLIER ON BANKRUPTCY ¶14.12, 14.43 at 1303-05, 1406-07 (14th ed. 1978). More specifically, under Bankruptcy Rule 407, a creditor who files a complaint pursuant to §17a(2) of the Act praying that the bankruptcy court declare a debt to be nondischargeable has the burden of proving fraud by evidence which is clear and convincing. Brown v. Buchanan, 419 F.Supp. 199 (E.D. Va. 1975).

The Court has examined the record and, in agreement with the decision of the Bankruptcy Judge, concludes that the Bank has failed to prove facts which would establish the required elements for an objection to discharge under §17a(2) of the Act. The Court concedes, as did the Bankruptcy Judge, that the evidence allows one to speculate that assets were overvalued and liabilities undervalued on the financial statements submitted to the Bank by Abboud. Still, fostering speculation does not amount to proof by "clear and convincing" evidence. Even if the Court were to accept as fact that the numerical errors on Abboud's financial statements were "materially false," the record strongly indicates the Bank failed to prove the intent and reliance elements that are also mandated by §17a(2) of the Act. Specifically, in regard to the Bank's allegation that Abboud overvalued the Bell Janitorial Service business, it is readily apparent that Abboud was merely estimating the value of the business on the basis of service contracts from which it could anticipate to draw income. Valuation of an ongoing business entity is far from an exact science. The

Bank failed to adequately prove that Abboud's valuation was totally without basis or even reckless. The same conclusion applies to dismiss the Bank's assertion that Abboud grossly overvalued his household furnishings. Further, in light of the Bank's close business dealings with Abboud, its claim that it relied on the financial statements without regard to the knowledge that it had or should have had concerning Abboud's actual financial condition is somewhat farfetched.

In conclusion, the record in this case, tested in the context of substantive legal standards and the allowable scope of review, fails to show that Abboud obtained loans from the Bank by making or causing to be made materially false written statements reflecting his financial condition. The conclusions of the Bankruptcy Court are supported by the evidence and are not clearly erroneous.

An order shall issue contemporaneously with this Memorandum Opinion .

Dated this 8th day of August, 1980.