

1960

# National Finance Company of Utah v. Carlos J. Valdez : Brief of Respondent

Utah Supreme Court

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IN THE SUPREME COURT

of the

STATE OF UTAH

**FILED**

SEP 1 - 1960

NATIONAL FINANCE  
COMPANY OF UTAH

*Plaintiff and Respondent,*

vs.

CARLOS J. VALDEZ

*Defendant and Appellant.*

Clerk, Supreme Court, Utah

Case No. 9137

UNIVERSITY OF UTAH

BRIEF OF RESPONDENT

JUL 10 1967

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*Defendant and Appellant.*

Case No. 9137

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BRIEF OF RESPONDENT

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STATEMENT OF FACTS

A re-statement of the facts appears necessary in some particulars. The defendant and his wife obtained a loan from the plaintiff in March 1957 in the sum of \$1920.00 and they executed a note and chattel mortgage as security, and at the same time the defendant Carlos J. Valdez, executed and delivered to the plaintiff a written statement concerning his financial condition. That said financial statement purported to be and was represented to be a complete statement as to the said Carlos J.

Valdez's financial condition on the date of the loan, to-wit, March 21, 1957.

The defendant Carlos J. Valdez filed a voluntary petition in bankruptcy in August 1957. Plaintiff filed suit in November 1957 to foreclose the mortgage, and alleged in its complaint facts to indicate this liability was not affected by a bankruptcy discharge because it was a liability founded upon false pretenses and false representations. The false pretenses and false representations were set forth in detail. The defendant answered setting up as an affirmative defense the discharge in bankruptcy of the defendant Carlos J. Valdez. The case came on for pre-trial at which time the prayer of plaintiff's complaint was amended to include the following: "That the court determine the claim herein sued upon be declared non-dischargeable in bankruptcy". The defendants stipulated for judgment against Rebecca M. Valdez, one of the defendants, and the Court at pre-trial after admissions by the parties found the only issues to be determined were; 1. Whether or not the court may under the pleadings as they are amended, find and enter an order that the obligation in question was not dischargeable in view of the provisions of Section 17-2 Federal Bankruptcy Act. Pre Trial Order 13.

When the case came on for trial the defendant again raised the bankruptcy of the defendant Carlos

J. Valdez by motion to stay proceedings, and argued that the Plaintiff had misconceived its remedy. R-17.

The Court's attention was called to the facts admitted at pre-trial — that the defendant Carlos J. Valdez prior to obtaining said loan and as an inducement to make said loan, submitted to plaintiff a written financial statement concerning his financial condition, that said financial statement purportedly was represented to be a complete statement as to the said Carlos J. Valdez's financial condition on March 21, 1957. That he represented that he had no other debts than those aggregating \$2500.00 with the effect of inducing said loan and the acceptance of said promissory note and chattel mortgage, whereas in truth and in fact, the defendant Carlos J. Valdez knew he was indebted in an amount aggregating more than \$3800.00. R-18 and 19.

Plaintiff offered to introduce evidence that the plaintiff relied upon the statement and did not know it was false and if it had known it was false, it would not have made the loan. The defendant then stated by Mr. Dibblee "I am stipulating, your Honor to the facts. Mr. Parkinson has shown me the papers that my client signed and he has made an investigation". R-20.

The facts stipulated were the facts alleged in plaintiff's complaint. That the defendant Carlos J.

Valdez secured the loan through a materially false statement in writing and that the defendant Carlos J. Valdez knew the statement was false, also that the plaintiff did not know the statement was false and that the plaintiff relied upon the statement and if plaintiff had known the true facts, would not have made the loan. The case was submitted entirely on a point of law, to-wit: "The application of Section 17 of the Bankruptcy Act. (11 U. S. Code Annotated Sec. 35)

## POINTS INVOLVED

### POINT I

CERTAIN DEBTS ARE NOT AFFECTED BY A DISCHARGE IN BANKRUPTCY, AND THE LIABILITY OR OBLIGATION TO PLAINTIFF IS ONE OF THOSE.

### POINT II

THE EFFECT OF THE DISCHARGE IN BANKRUPTCY IS DETERMINED IN THE FORUM WHERE THE QUESTION ARISES.

### POINT III

THE AUTHORITIES CITED BY THE DEFENDANT DO NOT JUSTIFY OR SUSTAIN HIS POSITION.

## ARGUMENT

### POINT I

CERTAIN DEBTS ARE NOT AFFECTED BY A DISCHARGE IN BANKRUPTCY, AND THE LIABILITY OR OBLIGATION TO PLAINTIFF IS ONE OF THOSE.

There are two sections of the Federal Bankruptcy Act bearing on the problem. Section 14 (11 U. S. Code Annotated 32) while not directly involved is of interest to aid in distinguishing objections to

a discharge, from liabilities which are not affected by a discharge in bankruptcy. Under Section 14 objections to a discharge are made directly to the bankruptcy court and are part of the bankruptcy proceedings. Objections are filed by any appropriate party who may be a creditor or other parties, or on occasion by the referee in bankruptcy.

When objections are sustained, a discharge is denied and the bankrupt does not receive a discharge on any debts, and all of bankrupt's liabilities remain in full force and effect. There is no such thing as a split or partial discharge. Under this section a denial of a discharge is equally effective as to all debts and a rather serious penalty. However, even to the party who has committed no acts that would result in the denial of a discharge, Congress has provided that even so quite a number of classes of debts are not affected by the bankruptcy discharge even though these debts are properly listed and a discharge in bankruptcy is granted.

It is the plaintiff's contention that the debt herein sued upon is one of those not affected by a discharge in bankruptcy. The debts not affected by a discharge are set forth in what is known as Section 17 of the Federal Bankruptcy Act.

Section 17 of the Bankruptcy Act (11 U. S. Code Annotated 35) is as follows:

“Sec. 17 Debts Not Affected by a Discharge. — a. A discharge in bankruptcy shall

release a bankrupt from all of his provable debts, except such as (1) are due as a tax levied by the United States, the State, county, district, or municipality in which he resides; (2) are liabilities for obtaining property by false pretense or false representations, or for willfull and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity; or (5) are for wages due to workman, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of commencement of the proceedings in bankruptcy; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment."

This section provides that the liabilities therein set forth are not affected by a discharge and continue exactly the same as though bankruptcy had not been taken.

Bear in mind that a discharge in bankruptcy does not ipso facto set up some new or different

relationship, but only furnishes the bankrupt with a defense to the enforcement of existing obligations. Bankruptcy is a defense that must be pleaded and if not pleaded, it is waived. Bankruptcy does not wipe out the liabilities, but only gives the bankrupt a defense to their enforcement. The liability or obligation continues and will support a new promise to pay without consideration. If one of the taxing units mentioned in Section 17, proceeds to enforce the liability to it, and a discharge in bankruptcy is pleaded as a defense, a determination is made that this liability is one of those described in Section 17, and is not affected by the discharge.

If a workman sues for wages and the discharge in bankruptcy is pleaded, the workman shows the wages were earned within three months prior to the commencement of the proceedings in bankruptcy and therefore the defense of bankruptcy does not apply.

If an employee sues an employer for money and the employer in turn pleads bankruptcy, the employee meets the affirmative defense of bankruptcy by showing that the money he sues for was held by the employer to secure the faithful performance of the employee, and therefore the bankruptcy discharge is not a good defense.

When the defendant Valdez conducted his transaction with the plaintiff, a liability to that plaintiff

was established. If that liability was not affected by a discharge, then it remains the same as though bankruptcy had not been taken.

In this case the plaintiff asserts a liability of the defendants and sets forth what he claims that liability to be, — this liability must be established and proved by the plaintiff. One of the defendants, Carlos J. Valdez, says “Yes, that is my liability but I have a defense. I am no longer bound by that liability because I have taken bankruptcy”. Plaintiff then meets this affirmative defense by setting forth that the defendant made false representations to induce plaintiff to enter into this transaction and therefore this debt is not affected by a discharge in bankruptcy — the defense does not apply.

The first question then is “What was the bankrupt’s liability to this creditor?” If that liability is not affected by a discharge — then the liability is exactly the same as though bankruptcy had not occurred. The Bankruptcy Act, Section 17, does not create a new or different liability but only provides the existing liability is not affected a discharge. Therefore the plaintiff in seeking to enforce the liability must set it forth — first in order to determine what if any liability existed. This the plaintiff must do by setting forth the liability of the bankrupt to the plaintiff and in proving and establishing that liability, as though bankruptcy had

never occurred, but unless that liability was founded upon false pretenses and false representations, it would be affected by the discharge in bankruptcy. Therefore, after setting forth the details of the liability which if the court please, is and was the exact liability set forth in the contract with the plaintiff, the plaintiff must then show why the discharge is not a bar to the enforcement of this liability. Were there no bankruptcy, I doubt if anyone would argue differently. They would readily admit the bankrupt's liability was exactly what the agreement or contract said it was. If that liability is not affected by a discharge, then it remains the same — but to avoid the defense or bar to the enforcement of this liability the false pretenses and false representations upon which that liability came into existence, must be shown, not to create a new or different cause of action, but to meet the affirmative defense set up by the bankrupt.

The discussion in many cases is that the false representations or false pretenses that must be shown (sometimes carelessly referred to as “fraud”) is not in conflict with this theory but supports it.

There are many cases to bear this out. A careful consideration and full understanding of the problem properly presented to the court has never resulted in a contrary decision. The case of *Ohio Finance vs. Greathouse*, 110 N.E. 2nd 805, is a concise,

direct and clear discussion of this point. In that case a judgment was rendered for the plaintiff; and the defendant prosecuted his appeal on questions of law, much the same as the instant case. Quoting from the case, the Court stated:

“The following questions material to a decision on this appeal are:”

“1. Did the discharge in bankruptcy relieve the defendant from liability on the note set up in plaintiff’s statement of claim, the execution of the note by defendant being admitted, his discharge in bankruptcy having been shown, wherein he listed this debt and gave notice to the plaintiff; who made no objection to the discharge in the bankruptcy court?.

“2. Did the plaintiff misconceive its remedy and by filing its action on contract instead of tort, thereby preclude itself from pleading the defendant’s tort by way of reply to the defendant’s answer, setting up the discharge in bankruptcy?”

“3. Could plaintiff attack in the municipal court, the bankruptcy discharge, or was it required to seek relief in the bankruptcy court to set aside such discharge on the ground of the alleged false pretenses and false representations of the defendant?”

“We are of the opinion that the answers to all of these questions are no longer debatable in view of the express provisions of the Bankruptcy Act and the several decisions of this court in which we follow the great weight of authority throughout the United States.

All of these questions must be answered favorably to the plaintiff appellee."

The case of *Argyle vs. Jacobs* 87 N.Y. 110 - 41 A.R. 351, is one of the early land mark cases on this subject and in agreement with the above analysis. It has never been overruled.

The above case is quoted at length in the case of *Gregory vs. Williams* 105 Kan. 819, 189 Pac. 932 as follows:

"Fraud was set up in the reply, not as a cause of action against the defendant but to avoid the defense that had been pleaded \* \* \* the action continues as an action on a promissory note. The reply did not constitute a departure from the cause of action alleged in the bill of particulars."

In *Crespi & Co. vs. Griffin* 132 Calif. App 562 - 23 Pac. 2nd 47, we find

"In the instant case, the obligation is on a promissory note, fraud was included and incidental to the creation of that obligation. That incident was properly urged without pleading to avoid the plea of a discharge in bankruptcy".

*Personal Finance of Waterbury vs. Robinson* 27 N.Y. Sup. 2nd 6 — the court stated the question was specifically passed upon in *Argyle vs. Jacobs* 87 N.Y. 110 - 41 A.R. 357.

"There as in the case at bar, an action was brought upon a promissory note and no fraud was alleged in the complaint. The an-

swer, as here, set up as an affirmative defense the discharge in bankruptcy. Upon the trial the plaintiff was permitted to give evidence tending to show that this debt was created by fraud of a bankrupt, which was the wording of the statute at that time. The Appellate court held this to be proper and affirmed the judgment for the plaintiff saying at page 113 - 87 N.Y., "but it is further contended on the part of the defendant's that the plaintiff cannot have the benefit of the limitation contained in the Act of 1867 because he did not base his cause of action upon the alleged fraud, but upon the promissory note, making no allusion to the fraud in his complaint. It is not provided that no cause of action for fraud shall be discharged, but that no debt created by fraud shall be discharged. These promissory notes were debts of the defendants and the plaintiff was induced by the fraud of the defendants to sell goods to them and to take their notes therefore and hence these debts were created by their fraud within the meaning of the bankruptcy act. It is not needful that the plaintiff should allege the fraud in his complaint, it was no part of his cause of action. It was needful only for him to prove that not as a part of his cause of action, but as an answer to the affirmative defense set up \* \* \*. The claimant may sue on contract and if the discharge in bankruptcy is pleaded, he may, in rebuttal, show that the debt was created by fraud, not to change his cause of action from contract to fraud, but to prevent its being disbarred by the discharge in bankruptcy."

*In Personal Finance vs. Martinez* 115 Fed. 2nd

226 (10th Circuit) — a careful reading of this case and a elementary mathematical computation will show the liability was co-extensive with the terms of the contract. This case shows a loan of \$110.00 was made on April 5, 1939; a suit was filed October 18, 1939 for \$150.00. This was allowed in the 10th Circuit Court and this case has never been overruled and from an easy computation, it can be seen the only way this liability could go from \$110.00 to \$150.00 in that period of time would be to allow the provisions of the contract to apply. In this case the court allowed recovery under the terms of the note and the false pretense and false representations avoided the defense of bankruptcy.

In *Blackman vs. McAdams* 11 S.W. 599, we find:

“This was an action on a promissory note executed by defendant to plaintiff. The petition was an ordinary declaration on a note. The answer set up defendant’s discharge in bankruptcy in the proper United States District Court. Plaintiff filed a reply to the answer in which he alleged the note was a liability arising by reason of defendants false pretense and false representations.”

“The first point made is that the matter alleged in the reply should have been set up in the petition. We think not. The answer set up new matter in alleging defendant’s discharge from the debt in bankruptcy. It was then proper to plead, by way of reply, such matter as put the case without the operation of discharge.”

In the case of *Personal Industrial Loan Corporation vs. Kenneth Dixon Forgay* 140 Fed. Sup. 473 — Judge Ritter made several observations, among them stating the case overruled the Martinez case which I have discussed above, these observations were corrected by the 10th Circuit Court decision in the same case found in 230 Fed. 2nd 18. There the court did not criticize the pleading of a note liability, but held that no facts had been alleged to show the liability was founded on false pretenses and false representations. There can be no doubt that if the allegations on the false pretense and false representations had been made to show the actual facts rather than conclusions, a recovery would have been allowed on the note. I quote

“It is elementary that fraud must be alleged by distinctly pleading the facts constituting the fraud. Mere epithets or conclusions or general charges \* \* \* are not good unless accompanied with a statement of the facts to sustain it \* \* \* it is necessary to show not only what the fraud was and that injury has been sustained, but also the connection of the fraud with the alleged damage, so that it may appear \* \* \* whether the one might have resulted directly from the other. No facts were pleaded which if admitted or established would support a fraud judgment.”

Collier on Bankruptcy 13 Ed. 616

“In a suit on a note, if the defendant pleads a discharge in bankruptcy, the plaintiff may set up fraud in his reply”.

*Personal Finance Company of Providence vs. Nichols* 43 Atlantic 2nd 314 —

“A debt created by fraud is not void but voidable only and therefore a creditor may assert both the debt and the fraud at the same time so long as he asserts the fraud to avoid not the debt but the discharge”.

The bankruptcy act does not create some new or different liability to the creditor, but only furnishes the bankrupt with a defense to the enforcement. When the defense is overcome by showing false pretenses and false representations, the liability continues unaffected by the discharge in bankruptcy. It was never intended that the doctrine of election of remedies should be invoked to preclude the introduction of proof to counter a special defense.

In an annotation found in 133 A.L.R. 466, is the following quotation:

“The defendant’s position is, in effect, that when the declaration is on a contract of sale and the plea is discharge in bankruptcy, the replication of debt created by defendant’s fraud is bad, that an issue upon a traverse of such replications is an immaterial issue and a trial of such an issue, a mistrial \* \* \* the plaintiff declares upon a promise of defendants to pay for goods sold, and, if he maintains his action, he maintains it upon the contract of sale affirmed by him. When a party has an election between two inconsistent rights or remedies — for instance, when he can rely

upon a contract, or renounce the contract and rely upon fraud — and he has knowledge of all facts material to be known in making a choice, his selection of one may be renunciation of the other, but the plaintiff in this case avers the fraud of the defendants, not as the plaintiff's cause of action, but as a refutation of the defendants' alleged defense of discharge. The plaintiff claims to recover damage not for the defendant's fraud but for the breach of his promise to pay for the good bought, and in the replication, he alleges the fraud, not as a ground upon which his action rests, but to show there is no ground on which the defendants discharge can be applied to this debt \* \* \* The statute recognizes the debt created by the fraud of the bankrupt is a debt not discharged and not affected by the proceedings of bankruptcy, except so far as it may be paid by a dividend. So far as this case is concerned, the debt, if created by the fraud of the bankrupt, is excepted out of the operation of the bankruptcy act. And when the plaintiff answers the plea of discharge by the replication of debt created by fraud, he does not attempt to rescind or invalidate or renounce the contract, but he affirms it, and claims that the debt is a valid subsisting debt. In the declaration he asserts the debt. In the replication he asserts the same debt. He avers the fraud, not to avoid the contract himself, but to show that the defendant cannot avoid it; not to show that by reason of the fraud, the debt declared upon was never created, but to show that being created by fraud, it was not discharged under the bankruptcy act; not to show that there is no such debt, but to show that there is such a debt

notwithstanding the discharge. In this course there is no inconsistency and the plaintiff is not estopped to answer the plea of discharge by the replication of debt created by fraud”.

## POINT II

THE EFFECT OF THE DISCHARGE IN BANKRUPTCY IS DETERMINED IN THE FORUM WHERE THE QUESTION ARISES.

This problem I believe has been adequately settled for many years. However, until very recently there was one case that indicated an obligation rested upon a creditor who had knowledge of facts which would preclude a bankrupt from being discharged, to advise the bankruptcy court thereof; that his failure to do so, would legally bar him from maintaining a subsequent suit against the bankrupt. In the case of *Harold F. White vs. Public Loan Corporation*, 147 Fed. Rep. 2nd 601, decided I believe in 1957, the court said:

“The Referee has based his decision upon the opinion and holding of Judge Reeves in the case of *In re: Walton D.C.W.D. Missouri* 51 Fed. Sup. 857 — that case held, in a situation similar to that here involved, that an obligation rested upon a creditor who had knowledge of any facts which would preclude a bankrupt from being discharged, to advise the bankruptcy court thereof, and on his failure to do so would legally bar him from maintaining a subsequent suit against the bankrupt related to his claim. Page 858. The opinion further declared that the bankruptcy court would also be equitably entitled, as a

mater of estoppel, to prevent such a creditor from harvesting the fruits of his bad faith scheme of allowing the debts of other creditors to be discharged and of leaving himself with the advantage of being able to pursue the bankrupt alone. Page 859.

‘However desirable these results may seem abstractly in relation to a bankruptcy proceeding, we do not believe that the language of Section 14 and 17 of the Bankruptcy Act, 11 U.S. Code Annotated Sec. 32 and 35, dealing with the granting of discharges and the effect thereof, admits of the application of any such qualifications or conditions.

“On the specificness and detail with which Congress took pains to cover the granting of discharges under Section 17, we can see no room for any implication that a creditor was to have a legal duty to advise the bankruptcy court of any information he might have which would preclude the bankrupt from being discharged — much less for any inference of a legislative intent that, if he failed to do so, he should be subject to the penalty in relation to Section 14, of not being able to maintain a suit against the bankrupt upon any debt he might have which was excepted from the operation of a discharge by Section 17.

“No more is there any room to append such qualifications and conditions and penalty to Section 17 itself. The exceptions provided for in Section 17, such as liabilities for obtaining money or property by false pretenses or false representations, are rights which Congress has chosen to exempt from bankruptcy administration and consequences and to leave

standing infavor of creditors, the same as they were before the bankruptcy proceedings. The exemption is self executing and no decree of the bankruptcy court is needed or is able to give it establishment.

“We therefore think the Walton case is wrong in its holdings that a bankruptcy court is entitled to deprive a creditor of the benefit of the exemption existing under Section 17, on the basis of his having failed to file objection, or to communicate information to the court, in relation to the bankrupt’s discharge. In this connection it may be noted that no other reported decisions appear o have followed the Walton case. As one bankruptcy text book authority has commented ‘The decision has absolutely no statutory basis to support it and must be regarded as erroneous’. I Collier on Bankruptcy 14th Ed. Section 14-07 footnote 4, page 1272.”

### POINT III

THE AUTHORITIES CITED BY THE DEFENDANT  
DO NOT JUSTIFY OR SUSTAIN HIS POSITION.

The authorities cited by the defendant do not justify or sustain his position. The case cited by defendant, *Personal Loan Co. vs. Forgay*, decided by District Judge Ritter in 140 Fed. Sup. 417, and by the 10th Circuit Court in 230 Fed. 2nd 18, was a case in a non-record court by default judgment without any indication or proof of false pretenses or false representations. The complaint alleged only a conclusion and the court held no false pretenses or false representations had been pleaded or proved,

and there were no Findings of Fact or Conclusions of Law to indicate evidence had ever been taken in that respect. We find in the decision of the Circuit Court, the following:

“The power to enjoin proceedings in a state court involving a debt listed in the bankruptcy proceeding or a judgment obtained on such a debt in a state court during bankruptcy proceedings or thereafter, is not an absolute power and may be exercised only under such conditions as appeal to the equitable conscience of the court.

“A due regard to our dual system of court requires a Federal Court to conclude that had the debtor presented his defense that the debt sued on in the state court was in fact dischargeable, the state court would have given it the consideration it merited, or that if the defense was offered and rejected by the state court, that it acted in good faith and that therefore the judgment was entitled to full faith and credit \* \* \* the default judgment it obtained is merely for the amount of the claim and did not purport to be a fraud judgment. In fact the judgment did not refer to fraud in any way.

“Mere epithets, or conclusions, or general charges, are not good unless accompanied with a statement of facts to sustain it \* \* \* it is necessary to show not only what the fraud was and that injury has been sustained, but also the connection of the fraud with the alleged damage, so that it may appear whether one might have resulted from the other. No facts were pleaded which if admitted or established would support a fraud judgment.”

In the case of *Beneficial Loan Company vs. Noble* 129 Fed. 2nd 425; the Federal Court held that federal courts would recognize the decisions and judgments of the state court. We find the following quotation:

“A default judgment was entered, debtor had consulted legal aid and was told to disregard the suit. On the hearing of the Order to Show Cause (Why plaintiff should not be enjoined) the referee found that no fraud was practiced on the loan company when the second loan was obtained, that the loan company did not rely on the financial statement given when the second loan was made \* \* \*

“Here however, the bankruptcy court did not undertake to exercise its jurisdiction with respect to allowance, rejection, or subordination of a claim, but undertook to inquire into the merits of the cause of action for fraud upon which the state court’s good judgment was predicated. The decision of the referee is therefore reversed.

In the case of *Household Finance Corporation vs. Dunbar* 262 Fed. 2nd 212; this case held that the defendant waived the defense of bankruptcy by failing to defend. On page 116 of the decision, we find:

“Here Dunbar had 70 days within which to set up the order of discharge as a defense in the state court action. He failed to do so and permitted judgment to go against him by default. We reluctantly conclude that Dunbar waived his defense to the state court ac-

tion and was not entitled to equitable relief in the federal court”.

The quotation by defendant from this case is dicta. The case does not deal in detail with the pleadings on the point covered in the quotation, there appears to have been no briefing on this point either by the court or the counsel, nor a complete consideration of the statement. It was a gratuitous statement and not necessary to or part of the decision and therefore the case does not decide the point for which defendant quoted it. In fact I have found no case, either in the defendant's brief or out, that has decided the point in favor of the defendant's position.

The case of *State Finance vs. Morrow* 216 Fed. Rep. 2nd 676 does not sustain the position of defendant. We find in the case:

“As a practical matter based upon the realities of the judicial processes in a court in which the issues are loosely passed, the bankruptcy court is unable to determine with any degree of satisfaction, whether the ultimate judgment of the court will be based upon the debt for which the note was given or the fraud which may have induced it. The court may well have taken judicial notice that the court in which the liability was asserted was not a court of record where issues of law and fact are defined with any degree of particularity and that for all practical purposes the bankrupt is defenseless. It is these practical considerations which prompt the bankruptcy

courts to exercise their equitable powers. Indeed, it is these considerations which impose upon them the inescapable duty to vouchsafe the integrity of their decrees. The trial court determined the adequacy of the remedy upon the face of the complaint and concluded that the appellants suit was upon the discharged debt. We think the court was fully justified in so doing \* \* \* It will thus be seen the latter section (\* \* \* Section 17 subdivision a) excepts liabilities for false pretenses and false representations from discharge. Section 14, subdivision c 3 authorizes the withholding of a discharge in its entirety on the grounds of fraud. The two sections are not mutually exclusive or paria materia, but they have been construed and administered to provide for an expeditious discharge of all provable debts and to leave the effect of a discharge to litigation in courts of competent jurisdiction where the decree of discharge is pleaded as a defense to a claim based upon liability obtained by fraud and false pretenses \* \* \* In short the right to a discharge and the effect of a discharge are entirely distinct propositions \* \* \*. The trial court's injunctive decree is based squarely upon the philosophy of *Local Loan vs. Hunt* 293 U. S. 234 - 54 Sup. Ct. 695; and *Seaboard Finance vs. Ottinger* 50 Fed. 2nd 856, at page 680.

The fact that the face of the complaint did not set forth facts showing that the debt was founded upon or was induced by false pretenses and false representations, was the controlling factor.

I do not believe the case of *Kinnear et al vs. Prouse et al*; 16 Pac. 2nd 1094 - 81 Utah 135, is in

point or is of any help in this case because the points there discussed are not involved in the present case. The distinction between the instant case before the court and the Kinnear case was amply set forth in the annotation quoted above in 133 A.L.R. 466. It was never intended that the doctrine of election of remedy should be invoked to preclude the introduction of proof to counter a special defense.

One other thing, if intention to deceive or conceal is necessary it is well established that this intent is supplied by the making of statements which are knowingly false or made with a reckless indifference to their truth or falsity. The burden is on the bankrupt to prove that he has not given a materially false statement within the meaning of the Bankruptcy Act where a creditor has shown reasonable grounds for believing that he has.

In *Third National Bank vs. Smatlock*, 99 Fed. 2nd 687, Page 689

“Where the objector has shown to the satisfaction of the court ‘reasonable grounds for believing’ the burden then shifts to the bankrupt to prove that he has not committed the acts charged”.

In the instant case it has been admitted the defendant made a materially false statement in writing; that he knew it was false and that the

plaintiff relied on the statement and that the plaintiff believed it to be true, and would have conducted himself differently if he had known the true facts.

The plaintiff submits the judgment of the District Court was proper and should be affirmed.

Respectfully submitted,

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