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Bankruptcy—Discharge—Effect of False Financial Statement Upon Prior Indebtedness

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WASHINGTON CASE LAW 1964-1965

Presented below is the twelfth annual survey of Washington Case Law. The articles in this survey issue were written by second-year students under the direction of the Recent Developments Editor of the *Law Review*.

This case survey issue does not represent an attempt to discuss every Washington case decided in 1964-65. Rather, its purpose is to point out those cases which in the opinion of the *Review* constitute substantial additions to the body of law in Washington.

During the coming year the *Law Review* will continue to collect Washington cases for publication in the 1965-66 survey issue. However, case notes on Washington decisions of national significance will be published as they are completed.

BANKRUPTCY

Discharge—Effect of False Financial Statement Upon Prior Indebtedness. In the 1961 case of *Household Fin. Corp. v. DeShazo*,[1] the Washington Suprere Court held that section 17(a)(2) of the Federal Bankruptcy Act[2] limited a creditor to recovery of the amount of an additional loan made in reliance upon a false financial statement, and did not permit recovery of prior indebtedness—not initially obtained by fraud—which was refinanced in the same transaction and included in the total amount of a new note.

DeShazo was overruled by a recent decision involving almost identical facts. In the recent case, plaintiff finance company relied upon defendants' false financial statement to increase defendants' existing indebtedness, and exchanged defendants' old note for a new note in the amount of $331.84. In an action on the new note, defendants claimed discharge in bankruptcy. The trial court considered *DeShazo* controlling and limited plaintiff's recovery to $94.89, the amount of the new loan plus interest. On appeal, *held:* A debtor is not discharged by section 17(a)(2) of the Federal Bankruptcy Act from liability for the

[1] 57 Wn.2d 771, 359 P.2d 1044 (1961). The action had been commenced June 18, 1959.

[2] 74 Stat. 409 (1960), 11 U.S.C. § 35 (a) (2) (Supp. V, 1963): "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as... (2) are liabilities for obtaining money or property by false pretenses or false representations, *or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive. . . .*" (Emphasis added.) The italicized language was added by amendment in 1960.

unpaid balance of prior indebtedness, not initially obtained by fraud, which was refinanced in reliance upon his false financial statement. *Federal Fin. Co. v. Merkel*, 65 Wash. Dec.2d 361, 397 P.2d 436 (1964).

The court in *DeShazo* had adopted a minority position,[3] finding that the basic policy underlying the Bankruptcy Act was to minimize the amount of enforcible debts after discharge in bankruptcy. When *DeShazo* was decided, a creditor acting in reliance upon a false financial statement had remedies under both sections 14(c)(3)[4] and 17(a)(2).[5] He could have prevented discharge in bankruptcy altogether under section 14(c)(3), or he could have sought recovery after discharge under section 17(a)(2). In 1960, section 14(c)(3) was amended to provide that discharge in bankruptcy can only be prevented if the bankrupt fraudulently obtained credit for specified *business* purposes.[6] The court in the principal case found that Congress, in exchange for the loss of power to prevent discharge in non-business cases, amended section 17(a)(2) so as to give small loan companies the "right to secure their whole indebtedness from a dishonest debtor...."[7] Consequently, the court in the principal case held that the 1960 amendments to the Bankruptcy Act required reversal of *DeShazo*.

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[3] The court in the principal case so recognized. 65 Wash. Dec.2d at 363, 397 P.2d at 437. In *DeShazo* the defendant was not in default on the existing note. Therefore, the court in *DeShazo* reasoned that the only "money or property" obtained by false representations was the additional amount of the new loan, while the majority of state courts held that an extension or renewal of existing indebtedness was also "property" within section 17(a)(2). Characteristic of the majority view is Personal Fin. Co. v. Bruns, 16 N.J. Super. 133, 84 A.2d 32 (1951). Characteristic of the minority view are Household Fin. Corp. v. Christian, 8 Wis.2d 53, 98 N.W.2d 390 (1957); Personal Finance Co. v. Murphy, 53 So.2d 421 (La. 1951). Cases are collected and discussed in Brief for Appelant, Federal Fin. Co. v. Merkel, 65 Wash. Dec.2d 361, 397 P.2d 436 (1964).

[4] Prior to amendment the section read as follows: "The court shall grant the discharge unless satisfied that the bankrupt has . . . (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition...." Ch. 575, 52 Stat. 850 (1938).

[5] *Supra* note 2.

[6] 74 Stat. 408 (1960), 11 U.S.C. § 32(c)(3) (Supp. V, 1963): "The court shall grant the discharge unless satisfied that the bankrupt has . . . (3) while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation...."

[7] 65 Wash.Dec.2d at 367, 397 P.2d at 439. The court also found congressional intent to bring the minority into line with already existing case law, citing S. REP. No. 1688, 86th Cong., 2d Sess. 2954 (1960); *Hearing on H.R. 106 Before a Subcommittee of the Senate Committee on the Judiciary*, 85th Cong., 2d Sess. 102 (1958). See Comment, *Effect of False Financial Statements on Debts Discharged in Bankruptcy—Section 17a(2) of the Bankruptcy Act*, 21 LA. L. REV. 638 (1961).

The decision in the principal case to overrule *DeShazo*, although based upon statutory amendment rather than reevaluation of the former rule,[8] has brought Washington law into line with the majority position.

COMMUNITY PROPERTY

Federal Savings Bonds—P.O.D. Beneficiary Other Than Surviving Spouse. The United States Supreme Court recently handed down a decision reversing the Washington Supreme Court which has important ramifications in all community property jurisdictions. The problem began when Angel N. Yiatchos purchased Series E United States savings bonds with community funds. Angel became registered owner of the bonds and his brother was designated P.O.D. (payable on death) beneficiary.[1] After Angel's death, his widow refused to deliver the bonds to the brother. The brother then brought suit against the widow individually and as executrix to determine ownership of the bonds. Angel's widow sought one-half interest in the bonds as her community share and asked that the proceeds of the remaining bonds be distributed to the devisees named in decedent's will.[2] On stipulated facts, the Supreme Court of Washington held that Angel's purchase with community funds of bonds payable to him alone, or to his brother upon his death, was in fraud of his wife's rights and was therefore void ab intio.[3] On appeal, the United States Supreme Court reversed and remanded. *Held:* Because Treasury regulations have the force of federal law, the P.O.D. beneficiary of federal savings bonds is entitled to the bonds unless their purchase by a husband with community funds is a "fraud" upon the wife as determined by federal law, and the wife has an undivided one-half interest in the bonds as a community asset. *Yiatchos v. Yiatchos*, 376 U.S. 306 (1964).

In the first Washington case involving the survivorship provisions of the Treasury regulations, *Decker v. Fowler*,[4] the court adopted the

[8] "Since we are convinced that congressional intent is clear in this case, we cannot substitute our judgment for the obvious policy decision that Congress has made here." 65 Wash.Dec.2d at 367, 397 P.2d at 439.

[1] 31 C.F.R. § 315.66 (1959) provides that upon the death of the registered owner, the P.O.D. beneficiary will be recognized as the sole and absolute owner of federal saving bonds.

[2] See WASH. REV. CODE § 11.04.050 (1963).

[3] *In re* Yiatchos Estate, 60 Wn.2d 179, 373 P.2d 125 (1962). See Comment, 38 WASH. L. REV. 255 (1963).

[4] 199 Wash. 549, 92 P.2d 254 (1939). The court rejected claims of the P.O.D. beneficiary to federal savings bonds on a gift theory, holding that, absent a valid delivery of the bonds, the designation of a P.O.D. beneficiary was ineffective as a gift. This rationale was severely criticized; see 14 WASH. L. REV. 312 (1939). Legislation designed