IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

UNPUBLISHED OPINION

In re	)	Bankruptcy Case No. 82C-02921
	)	
DAVID C. HANSEN and CAROL L. HANSEN,	)	
	)	
Debtors.	)	
	)	
THE LOCKHART CO.,	)	
	)	
Plaintiff.	)	
	)	Civil Proceeding No. 83PC-0010
vs.	)	
	)	
DAVID C. HANSEN, CAROL L. HANSEN, DAVID L. DRAPER, NATURES ESTATES AND ASSOCIATES, a corporation, MICHAEL E. LUND, and MILDRED L. LUND,	)	
	)	
Defendants.	)	MEMORANDUM OPINION

APPEARANCES

Bruce A. Maak, Larsen, Kimball, Parr & Crockett, Salt Lake City, Utah, for the plaintiff; William Thomas Thurman and Evan A. Schmutz, McKay, Burton, Thurman & Condie, Salt Lake City, Utah, for the debtors/defendants; Harold R. Stephens, Salt Lake City, Utah, for defendants Lund. Because plaintiff's action against defendants David L. Draper and Natures Estates & Associates was stayed by operation of 11 U.S.C. § 362, those defendants did not participate as parties to this proceeding.

This adversary proceeding came before the Court for trial on April 25, 26, 27, 1984. Upon hearing the evidence and arguments presented by the parties, the Court renders judgment as follows:

JURISDICTION

The Court has jurisdiction over the subject matter of and parties to this adversary proceeding pursuant to 28 U.S.C. § 1334(b) and the General Order of Reference of the United States District Court for the District of Utah dated July 10, 1984 entered pursuant to 28 U.S.C. § 157(a). This is a "core proceeding" within the meaning of 28 U.S.C. § 157(b)(2)(A), (C), (I), (K) and (O).

CLAIMS OF THE PARTIES

The Lockhart Claims. The plaintiff, The Lockhart Co. ("Lockhart"), claims that (1) defendants David C. Hansen and Carol L. Hansen ("Hansens"), David L. Draper ("Draper"), and Natures Estates & Associates ("Natures") executed a promissory note in favor of Lockhart in the principal amount of $32,132.00; (2) the note was secured by a trust deed on certain real property located in Sanpete County, Utah (the "Fairview property" or "property"); (3) the trust deed is superior in priority to the interest of Michael E. Lund and Mildred L. Lund ("Lunds"); (4) the Hansens, Draper, and Natures are in default on the loan,

owing Lockhart $30,132.00 at 18% per annum from and after February 11, 1980 until paid; (5) the Hansens represented to Lockhart that they owned the property in Sanpete County; (6) the Hansens pledged the property as collateral to secure the note owing to Lockhart; (7) the Hansens misrepresented to Lockhart their ownership of the property; (8) prior to pledging the property to Lockhart by deed of trust, the Hansens conveyed the property to the Lunds; (9) the Hansens delivered to Lockhart a false financial statement upon which it reasonably relied in making the $30,132.00 loan; and (10) the Hansens are not entitled to a discharge of their debt to Lockhart.

The Lund Claims. Defendants Lund claim that (1) the Hansens knew that the Lunds had constructed a home on the property at the time the Hansens conveyed the trust deed to Lockhart; (2) the Hansens fraudulently obtained the loan from Lockhart by deliberately misrepresenting their ownership interest in the property; (3) the Lunds had possession of the property at the time the trust deed was conveyed to Lockhart; (4) Lockhart accepted the trust deed from the Hansens with constructive notice of Lunds' claim to the property; (5) the Lunds' interest in the property is superior to that of Lockhart; and (6) if Lockhart's deed of trust is found to be superior to their interest in the property, the Hansens would be liable to the Lunds for punitive damages.

The Hansen Claims. Defendants Hansen claim that (1) at the time they pledged the property as security for their loan to Lockhart, they believed they were the rightful owners thereof; (2) the Hansens knew the Lunds had a mobile home on the subject property, but the Hansens did not think that fact divested the Hansens of their ownership interest; (3) the Hansens never conveyed the property to the Lunds; (4) on or before the date they pledged the property to Lockhart, the Hansens fully disclosed to Lockhart that the Lunds were occupying the property, and Lockhart told the Hansens that the Lunds "would be no problem"; (6) Lockhart limited the Hansens' liability on the note to the subject property; (7) the Hansens believed that the financial statement they submitted to Lockhart was accurate; and (8) the Hansens made no false statements to Lockhart upon which Lockhart relied.

FINDINGS

1. In December of 1972, Max W. and Beda L. Nelson, the father and mother of Carol L. Hansen, made a gift to the Hansens of certain unimproved real property in Fairview, Utah. This property has the following legal description.

> Beginning 16.50 feet West, 132.00 feet South of the Northeast corner of the Northwest quarter of Section 2, Township 14 South, Range 4 East, Salt Lake Base and Meridian; thence East 226.71 feet; thence South 66.00 feet; thence West 228.86 feet; thence North 66 feet to beginning.

This lot is one of four owned by Nelson and his children. The four lots comprise the Fairview property which is the subject of the Lunds' claim in this case.

2. Nelson's daughter Joyce told him that the Michael E. and Mildred L. Lund of Fairview were selling their service station, and Nelson began exploring the possibility of purchasing the service station.

3. Nelson told Michael Lund about the four lots constituting the parcel of property in Fairview. Lund was willing to exchange his tire inventory and gasoline inventory for the Fairview property. Nelson claimed to own one lot; the other three were in the name of Nelson's children. Nelson showed Lund the deeds to the lots.

4. David C. Hansen and Carol L. Hansen are husband and wife. Mr. Hansen obtained his real estate licence in late 1977 after completing thirty hours of coursework at Utah Technical College. There he learned the significance of a warranty deed and a trust deed and was exposed to the real estate laws of Utah. In his real estate transactions, he relied for legal advice on his attorney, Andrew McCullough. Mr. Hansen made his living principally from his real estate work for about two years. In that time, he worked as a broker, though not the principal broker, and made 35 to 40 sales.

5. At trial, Max Nelson identified Exhibit #5, which is a warranty deed from Max Nelson and his wife to David and Carol Hansen. This deed covers one of the four parcels making up the Fairview property in question.

6. Hansen testified that Nelson wished to make the deal with Lund for the property exchange and told Hansen he wanted the property back from Hansen for this purpose. Hansen claims never to have executed any document effecting a reconveyance of the property to Nelson.

7. Negotiations took place between Nelson and Lund. Nelson testified that Lund told him of the Lunds' need for a parcel of property on which to move a mobile home and that Nelson told Lund that he could temporarily move his mobile home on the Fairview property for the next two or three months, until the Lunds found a place to live.

8. The Lunds purchased a mobile home and moved it onto the Fairview property in July of 1978. They built a foundation, had electrical power hooked up, and added rooms and a garage.

9. Nelson saw the mobile home from the highway while the foundation was being constructed and again following the construction.

10. Nelson asked his children for deeds in the event he sold the property. In 1979 the Hansens returned the deed to Nelson and did not participate in negotiations with the Lunds.

11. The Nelsons and the Lunds closed the sale of the service station, but there is presently no document in existence wherein the Hansens agreed to sell the Fairview property to the Lunds. There is an agreement relating to the sale of the service station, but it mentions no property. The sale of the lots was based upon oral statements. The terms of this agreement were these: Nelson was to pay $30,000.00 at closing for the service station and assume the balance of $140,000.00 mortgage over 30 years. Lund was to get the four Fairview lots. No further consideration was to be paid by Nelson. For this the Lunds agreed to the transfer of the service station. No mention was made of the tire inventory. Nelson thought he was getting the real property as well as the personalty located on the service station premises. Nelson thinks Lund breached his agreement by taking personal property from the premises.

12. At the time of the closing, Lund learned that Nelson and his children owned the four lots comprising the Fairview property.

13. The Lunds moved into the mobile home on the Fairview property within a few days of the closing on the service staion deal. Lund assumed the responsibility for tax payments on the property for the year 1979 and thereafter on all four lots comprising the Fairview property. The annual property tax was approximately $300.00 for all four lots.

During the period in which the Lunds occupied the property, it was not possible to tell by looking at the property who owned it, for there was no mail box, no sign, or anything to identify the house as belonging to the Lunds.

14. Lund requested deeds to the lots from Nelson, but never received them.

15. Nelson asked his lawyer to get the Lunds off the property or cause them to lease it. Meanwhile, the Lunds were trying to sell the property through a real estate agent.

16. Nelson claims that three days after the closing of the sale of the service station, he told David and Carol Hansen that he had not given Lund a warranty deed to the Fairview property. This was the assurance upon which Hansen later claimed that Lund did not get the property, did not want it, and that the property was not part of the service station deal.

17. By early 1980, the Lunds and their children were living in the mobile home. The Lunds never met David Hansen until they saw him in state court in connection with an eviction action commenced by Hansen. The Lunds counterclaimed in that action, seeking to quiet title to the Fairview property in themselves.

18. The Lunds did not learn of Lockhart's claim against the Fairview property until the last day of the state court action.

19. Defendant David L. Draper is a resident of American Fork, Utah. He has purchased property before and is familiar

with deeds and covenants of transfer. He had known the Hansens for over five years at the time of this hearing.

20. In 1979, Hansen decided to invest in David Draper's Natures Estates & Associates. Apparently, Draper needed money to pay arrearages on his own loan. In order to fund this investment, Hansen decided to obtain a loan to be secured by the Fairview property. Originally Hansen and Draper sought a $40,000.00 loan with the intent of using $30,000.00 for the investment with Natures, holding back $10,000.00 of the loan proceeds to fund Hansen's litigation with the Lunds over the ownership of the property. There is no written documentation that Hansen agreed to hold back $10,000.00 for the litigation; this was done pursuant to an oral agreement between Hansen and Draper. Hansen, for his investment, was to have received stock in Natures Estates or in the joint venture with David Draper.

It is clear from his testimony that Hansen intended to pledge as collateral a parcel of real property the title to which he knew was yet to be quieted by litigation.

21. Hansen knew that the Nelsons and the Lunds had begun to dispute the terms of their agreement. He also knew that he held record title to part of the Fairview property.

22. Hansen viewed the Fairview property from his car in 1979, after receiving a tax notice that alerted him that there might be improvements on it. He noted a home on the property.

He also noted that some attempt had been made to attach a porch to it. He saw no wheels on the home.

23. Hansen first attempted to obtain a loan from Gate City Mortgage. But after Hansen told Gate City about the Lunds' claim of ownership, Gate City refused to make the loan. It was then that negotiations began with the Lockhart Company.

24. In January of 1980, Draper contacted Hansen about getting an investment loan from Lockhart. Draper said Hansen contacted Lockhart for the loan. Eventually, both Draper and Hansen spoke with Alan Manley, who had been an employee of Lockhart for 16 years. He was the manager of the Orem, Utah, branch of Lockhart at the time Hansen and Draper applied for their loan.

25. Manley testified that Draper contacted him first. A meeting was set up, which both Hansen and Draper attended. At this first meeting, the property was discussed. Hansen stated that he owned it and that it was worth $50,000.00 to $60,000.00. Hansen said he wished to pledge the property as collateral, and Lockhart would have a first mortgage thereon.

26. Draper has no recollection of telling Lockhart about the title problems with the property. Draper remembers having a conversation with Hansen about the Lunds, but does not remember that Hansen ever had such a conversation with Lockhart. Hansen may have said that he had a dispute with some tenants or

"renters" on the property, but Hansen never mentioned the title problem.

27. Manley had several other meetings with Hansen and Draper within a period of 10 to 15 days after the first meeting in January, 1980. Manley asked both Hansen and Draper for personal financial statements, and a corporate financial statement for Natures Estates & Associates. He also asked for an appraisal on the property. During this same period, Hansen and Draper provided Manley with a title report from Imperial Land Title, Inc., and an agreement between Hansen and Natures Estates in which Hansen -- representing himself as the owner of the property -- agreed to allow Natures to pledge the property to Lockhart as security for the loan, providing Natures would be responsible for the loan payments. Attached to this agreement was a copy of the Imperial title report, dated January 24, 1980. This report did not show the interest, disputed or otherwise, of the Lunds, nor the existence of any agreement that Hansen would reconvey title to the property to his father-in-law, Nelson. The report merely showed David C. and Carol L. Hansen as the record owners and that the property had assessed against it a total of $254.81 in unpaid property taxes.

28. Hansen obtained from the Lockhart Company a loan application form which he completed and signed. As part of this application, Hansen also provided Lockhart with a financial

statement. Hansen's claim of net worth, as set forth in this financial statement, is in part based upon the appraised value of the Fairview property in the sum of $62,000.00. However, only $6,000.00 of that sum constitutes the value of the unimproved real property; the remaining $56,000.00 represents the value of the mobile home on the subject property. It is obvious that Hansen included in his financial statement as an asset the mobile home purchased by the Lunds.

29. Manley always believed that the title to the collateral was in the Hansens' name. He was told that the renters occupying the property were being evicted. He was never told there was a dispute regarding the title to the property.

30. Lockhart obtained an independent title report on the property from Associated Land Title, Inc., as well as a credit report on Hansen and Draper. Lockhart learned that Hansen's ability to repay was good. On his financial report, Hansen showed a net worth of $108,469.00 of which $56,000.00 represented the value of the mobile home on the property. It is clear that without including the value of that home as an asset, Hansen's net worth would only have been $52,469.00.

31. Lockhart did not know that the title to the property was in dispute or that Hansen contemplated a lawsuit to clear title, or that Hansen did not own the mobile home, or that his net worth was less than $55,000.00, or that some of the loan

proceeds were obtained to pay legal fees and costs to clear title to the property. Had Lockhart known any of these facts, the loan would not have been approved. Manley also testified that Hansen's actual net worth would not have been enough to warrant Lockhart's granting him a loan of $30,000.00.

32. Manley knew that Gate City Mortgage had rejected Hansen's and Draper's loan applications, but did not know why that happened. Manley never discussed fully with Hansen and Draper why Gate City refused their loan applications. Hansen and Draper told Manley that Gate City turned them down because the mobile home was not valuable enough and it was too far away to serve as security. Manley did not inquire as to the reasons for Gate City's refusal because Gate City is a first mortgage lender, while Lockhart is a second mortgage lender. The two companies have differing qualification standards. Manley made no further inquiry with regard to the Lunds because Hansen told him that the occupants of the property were "renters," and that they were in the process of being evicted.

33. Manley testified that he was relying upon Hansen's financial statement for the ability of the obligees to repay. Manley explained that in the event of a default Natures Estate would be contacted first. But Manley made it clear that Draper and the Hansens, as individuals, would be obligated on the note. Manley stated that in approving a loan, each borrower must

qualify separately, and Natures Estate would have qualified had it not been in default on its loan. Where a borrower does not qualify, it is Lockhart's policy to look to the cosigner's asset picture.

34. Manley put together the information he had garnered into a package for his superiors at Lockhart. He recommended the loan be made because the security was good, the repayment power was good, and the borrowers' credit rating was good. Lockhart made no inspection of the premises and did not make further inquiry about the occupants.

35. Although Hansen and Draper had applied for a $40,000.00 loan, Lockhart approved the loan for only $30,000.00.

36. The closing of the Hansen/Draper loan was conducted on February 11, 1980 in the Lockhart offices in Orem, Utah, by David Palfreyman. Palfreyman was the assistant manager of Lockhart's Orem, Utah, branch, and had worked there since September of 1978. On the date of the closing Alan Manley reviewed the loan documents with Palfreyman. Manley told him that the loan was Hansen's, that David C. and Carol L. Hansen were to sign as principal obligors, that Draper was a co-signer, that Draper was to sign individually and as president of Natures Estates & Associates, that the security was a certain parcel of property in Fairview, Utah, that Palfreyman was responsible for proof-reading the property description, that the documents were not to leave

Lockhart's office, that all signatures were to be affixed in Palfreyman's presence, and that the terms of the loan were to be reviewed with each obligor.

Palfreyman explained the terms of the loan and carried out his responsibilities, first in the presence of David Hansen and David Draper and then, after Draper left and Carol Hansen arrived, he repeated his explanation for her benefit. Palfreyman never stated that Hansen would be obligated only to the extent of the value of the collateral he was pledging. He explained that all obligors would be bound by the terms of the note and that they would all be liable thereunder, including Mrs. Hansen. Palfreyman told them that the property, which was vested in the Hansens, would be foreclosed upon in the event of default and that all parties would be liable for any deficiency. Draper balked about signing individually, but he did so. All pertinent loan documents were signed in Palfreyman's presence.

37. A promissory note dated February 11, 1980 in the sum of $30,132.00 was prepared and executed by David C. and Carol L. Hansen and by David L. Draper, individually and as president of Natures Estates & Associates. A trust deed of even date was also prepared for the subject property, and it was executed by David C. and Carol L. Hansen.

38. After the loan documents were executed by Hansen and Draper, they asked that the money be dispersed that afternoon.

Palfreyman reported the details of the closing to Manley that day and called the title company to have the trust deed recorded.

39. On February 13, 1980, a check was issued by Lockhart to Hansen, Draper, and Natures Estates in the sum of $30,000.00. This check was endorsed to Natures by the Hansens on the same day. On that same date, Natures made a check for $10,000.00 to the Hansens.

40. The Hansens used all or part of the proceeds of this $10,000.00 check to pay the legal fees of their attorney to prosecute their eviction action against the Lunds.

41. Manley learned of the lawsuit between Hansen and Lund after the loan closed. Hansen either called or paid a visit to the Lockhart offices and told Manley about the problem. This occurred about six months after the closing, which was the same time the loan went into default.

42. Following trial of the action, the Sanpete County District Court, Judge Tibbs, entered judgment quieting title to the property in favor of the Lunds. This judgment was recorded as a lien upon the property.

43. Lund owes Deseret Federal Savings and Loan $24,000.00 on the mobile home. Lockhart claims an interest in the sum of $30,000.00. Lund believes the home was worth $69,000.00 as of the time of the state court action. Today it has a value of $48,000.00.

44. Draper filed a Chapter 7 petition on April 6, 1983 and was subsequently discharged. Natures Estates is insolvent.

45. Bruce Maak, attorney for Lockhart, testified that he incurred fees and costs in the state action involving all the same parties, resulting from his preparation of pleadings and papers, jury instructions, and subpoenas. He also incurred fees in this adversary proceeding before the bankruptcy court, resulting from negotiations, his preparation of the complaint, the answer to the counterclaim, the pre-trial order, two briefs, the assembled and marked exhibits, review of opposing briefs, and participation in the three-day trial itself.

DISCUSSION

I.

Did Hansen or Lund Own the Fairview Property?

The parties have raised the issue of whether the plaintiff and defendants are bound by the judgment and findings of Judge Tibbs in the Sanpete County action. Lockhart, which was not a party to that suit, does not ask this Court to overturn the decision of the state court, but wants a determination that the Lunds' position in the subject property is inferior to its position. Under the doctrine of res judicata, a valid judgment on the merits, if properly pleaded, bars a second suit on the same cause of action. 1B J. Moore, MOORE'S FEDERAL PRACTICE

¶ 0.410[1], at 348 (2d ed. 1984). Res judicata ensures the finality of decisions and encourages consolidation of an entire dispute. Cutler v. Tebbs (In re Tebbs), unpublished memorandum opinion, no. 79-00965 (Bkrtcy. D. Utah Aug. 19, 1980). The doctrine prevents the same parties from litigating the same controversy twice, but does not preclude third parties who were not parties to the original action from pursuing their remedies in a subsequent proceeding. Applying the doctrine of res judicata to this proceeding, the Court determines that the judgment rendered by Judge Tibbs in the Sixth Judicial District Court of the State of Utah, in and for Sanpete County, is binding in this present suit upon the Hansens and Lunds. There is no legal basis for this Court to consider the question of title to the Fairview property as between those parties. However, since the plaintiff, Lockhart, was not a party to the state court action, the doctrine of res judicata does not apply to Lockhart, which has the right, therefore, to fully litigate in this Court the question of whether the Lunds' ownership interest in the property is superior or inferior to the lien of Lockhart.

II.

Does Lund or Lockhart Have a Superior Interest in the Fairview Property?

A. Is Parol Evidence Admissible Under These Circumstances to Establish Lund's Interest in the Property as Against Lockhart?

The defendants Hansen contend that they had a verbal understanding with Lockhart that they would not be personally liable on the promissory note. Lockhart objected to the admissibility of parol evidence to vary the terms of the note.

The parol evidence rule operates in the absence of fraud to exclude contemporaneous conversations, statements, or representations offered in evidence for the purpose of varying or adding to the terms of an integrated agreement. Union Bank v. Swenson, __ P.2d __, 19 Utah Adv. Rep. 22, 23 (Utah Sept. 27, 1985). When an agreement is ambiguous, because of the uncertain meaning of terms, missing terms, or other facial deficiencies, parol evidence is admissible to explain the parties' intent. Messick v. PHD Trucking Service, Inc., 678 P.2d 791, 795 (Utah 1984). Another well recognized exception to the rule is for fraud. State Bank of Lehi v. Woolsey, 565 P.2d 413, 418, 22 U.C.C.R.S. 1 (Utah 1977). Absent fraud or some other invalidating cause, the integrity of a written contract is maintained by not admitting parol evidence once the instrument is determined to be an integrated agreement. Union Bank v. Swenson, supra.

As a preliminary question of fact, the Court must determine whether the note was intended by the parties to be an integrated agreement. Id. Whether a writing has been adopted as an

integrated agreement is a question of fact to be determined from all relevant evidence. RESTATEMENT, SECOND, CONTRACTS § 209(2) and Comment c (1981). There is a rebuttable presumption that a writing which on its face appears to be an integrated agreement is what it appears to be. Union Bank v. Swenson, supra. "Where the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement unless it is established by other evidence that the writing did not constitute a final expression." Id., quoting RESTATEMENT, SECOND, CONTRACTS, supra, § 209(3).

The note in question here is clear and unambiguous with respect to the rights and liabilities of the parties. By its terms it obligated the Hansens, jointly and severally. The parties appear to have intended the note to be an integrated agreement. The defendants Hansen have made no showing that they were induced to sign the note through fraud, or that any irregularities existed in connection with its execution. Accordingly, the Court finds that the promissory note was a completely integrated agreement between Lockhart and the Hansens and parol evidence is, therefore, inadmissible.

B. As Against Lockhart, Did the Lunds Obtain Title to the Fairview Property Despite Their Failure to Comply with the Statute of Frauds?

1. The Part Performance Exception to the Statute of Frauds

The Lunds contend that their interest in the Fairview lots, based on an oral agreement with Nelson, is superior to the later recorded trust deed of Lockhart.

Ordinarily, an oral agreement to convey land is within the statute of frauds. Martin v. Scholl, 678 P.2d 274, 275 (Utah 1983). Utah Code Ann. § 25-5-1 provides:

> Estate or interest in real property. No estate or interest in real property, other than leases for a term not exceeding one year, nor any trust or power over or concerning real property or in any manner relating thereto, shall be created, granted, assigned, surrendered or declared otherwise than by act or operation of law, or by deed or conveyance in writing subscribed by the party creating, granting, assigning, surrendering or declaring the same, or by his lawful agent thereunto authorized by writing.

However, under Utah Code Ann. § 25-5-8, an oral agreement to convey real property may be enforced if it has been partially performed. That section provides:

> Right to specific performance not affected. Nothing in this chapter contained shall be construed to abridge the powers of courts to compel the specific performance of agreements in case of part performance thereof.

To meet the part performance exception to the statute of frauds, the terms of the oral contract must be clear and definite

and established by clear and definite testimony. Bradshaw v. McBride, 649 P.2d 74, 79 (Utah 1982). In Coleman v. Dillman, 624 P.2d 713, 715 (1981), the Utah Supreme Court stated the four-part test for when a purchaser in possession of land who has made improvements on it may invoke the doctrine of part performance. The party must show that (1) possession was actual, open, exclusive and with the seller's consent; (2) improvements made were substantial, valuable and beneficial; (3) a valuable consideration was given in exchange for the conveyance; and (4) all of the foregoing were exclusively referable to the contract.

In a situation where possession, improvements and consideration are not exclusively referable to a contract, but are equally consistent with a rental agreement, the fact of possession, improvements and consideration will not constitute sufficient part performance to operate as an exception to the statute of frauds. Id. But "where either independent acts which prove the contract can be found, or an admission of the contract is present, the requirement of exclusive referability may be relaxed because the evidentiary concern is assuaged by either the admission or the independent acts. Consequently, the more conclusive the direct proof of the contract, the less stringent the requirement of exclusively referable acts." Martin v. Scholl, supra, 678 P.2d at 278.

The state court found that after the Lunds sold Nelson and Hansen the service station, the Lunds made an oral agreement for the sale of the tire and gas inventory in exchange for the Fairview property. After the oral agreement was made, the Lunds took possession of the property. The possession was open, notorious and exclusive, and it was taken with the consent of Hansen and Nelson. The Lunds paid valuable consideration for this land and made substantial improvements, including a foundation, porch, and added rooms to the mobile home placed on the property. The presence of the Lunds on the property is not referable to any extant rental agreement. There is testimony that Hansen told Lockhart that the Lunds were renters, but there is no evidence that there was any rental agreement, written or oral, between Hansen and Lund. Lund's possession of the property appears to be a result exclusively of the agreement to sell the property in exchange for inventory. As a matter of law, therefore, this Court finds that the Lunds' acts constitute part performance.

2. Ratification of the Oral Agreement Between Nelson and Lund by Hansen

Ratification is the affirmance by a person of a prior act which did not bind him but which was purportedly done for him, whereby the consequences of the original act are the same as if

it had been authorized. RESTATEMENT, SECOND, AGENCY § 82 (1958). A principal (Hansen) may impliedly ratify an agreement made by an unauthorized agent (Nelson). Bradshaw v. McBride, supra, 649 P.2d at 78.

The intent to ratify an unauthorized transaction may be inferred from a failure to repudiate it. RESTATEMENT, SECOND, AGENCY, supra, § 94. Also, a party may be bound by inaction, and mere silence, the performance of the contract, or acceptance of benefits under it can constitute ratification. Any conduct on the principal's part which manifests consent is sufficient to operate as ratification, and if the circumstances are such that the principal could and should dissent unless he is willing to be a party to the transaction, but does not, he will be held to have ratified the acts of an unauthorized agent. Bradshaw v. McBride, supra, 649 P.2d at 78. See also RESTATEMENT, SECOND, AGENCY § 93(1).

In the present case, Hansen ratified the transactions between Nelson and the Lunds by:

(1) giving Nelson a deed to the Fairview property for the purpose of negotiating a sale of the service station and inventory with the Lunds;

(2) not objecting to Nelson's negotiating with the Lunds;

(3) not objecting to Nelson's purchase of the service station from the Lunds; and

(4) allowing Nelson to act for the Hansens with respect to the property.

3. Was Lockhart a Good Faith Purchaser for Value Such That Lockhart's Recorded Interest Will Defeat the Lunds' Prior Unrecorded Interest in the Property?

Given that the Lunds had title as against Hansen, the Court is called upon to construe the Utah Recording Statute and to determine whether the Lunds' prior unrecorded ownership interest is superior to Lockhart's later recorded interest in the Fairview property. Utah Code Ann. § 57-3-3 provides:

> Effect of Failure to Record. -- Every conveyance of real estate hereafter made, which shall not be recorded as provided in this title, shall be void as against any subsequent purchaser in good faith and for a valuable consideration of the same real estate or any portion thereof, where his own conveyance shall be first duly recorded.

For the Lunds' prior unrecorded ownership interest to defeat Lockhart's later recorded interest, the evidence must show either that Lockhart was not a "good faith purchaser" or did not give "value" for its interest. Clearly Lockhart gave value in the form of a $30,120.00 loan to Hansen and Draper. The question, then, is whether Lockhart was a "good faith purchaser"; that is, did Lockhart obtain its lien against the property without

knowledge (actual or constructive) of the outstanding ownership claims of the Lunds?

Utah, like most states, has a "race-notice" recording act. Utah Code Ann. § 57-3-3, supra. See 4 AMERICAN LAW OF PROPERTY § 17.5, at 545 n. 63 (1952); 6A POWELL ON REAL PROPERTY ¶ 905[1][c], at 85-26 (1985). Under a race-notice act, if a common grantor conveys the same land to two persons, the first to record prevails so long as that person had no actual notice of the earlier conveyance. Id.

What constitutes "actual notice" lies at the heart of the present controversy. Obviously, where a party knows of an unrecorded instrument by full information directly received there is actual notice. See AMERICAN LAW OF PROPERTY, supra at § 17.11, pp. 564-65. But courts may impute notice to a subsequent purchaser in some circumstances where such direct knowledge does not exist. Where notice is thus imputed to a party it is known as "constructive notice," one form of which is "inquiry notice." It exists when the circumstances are such that the purchaser has information of a fact or facts that would provoke a reasonable and prudent person in his position to make an investigation. Id. at 565-66. Johnson v. Bell, 666 P.2d 308, 310 (Utah 1983); Toland v. Corey, 6 Utah 392, 24 P. 190 (1890), aff'd 154 U.S. 499, 14 S.Ct. 1144, 38 L.Ed. 1062 (1893). See also POWELL ON REAL PROPERTY, supra, at 82-29. When the

facts suffice to impose the duty of investigation, the purchaser is charged with notice of what a proper investigation would have discovered, whether or not the purchaser actually made an investigation. Id.; O'Reilly v. McLean, 84 Utah 551, 563, 37 P.2d 770, 776 (1934); Corey v. Roberts, 82 Utah 445, 25 P.2d 940, 949 (1933); LeVine v. Whitehouse, 37 Utah 260, 109 P. 2, 9 (1910).

The necessity for such an investigation may arise out of a number of different circumstances which raise suspicion concerning the true facts surrounding a claim of title. In many jurisdictions, including Utah, possession of the property by someone other than the record owner creates a duty to inquire. See, e.g., Stevens v. American Savings Institution, Inc., 289 Ore. 349, 613 P.2d 1057, 1061 (1980); Cohen v. Thomas & Son Transfer Line, Inc., 196 Colo. 386, 586 P.2d 39, 41 (Colo. 1978); Yancey v. Harris, 234 Ga. 320, 216 S.E.2d 83, 84 (1975); Smelsey v. Guarantee Finance Corp., 310 Mich. 674, 17 N.W.2d 863, 864 (1945); Meagher v. Dean, 97 Utah 173, 91 P.2d 454, 456-57 (1939); Neponset Land & Livestock Co. v. Dixon, 10 Utah 334, 336, 37 P. 573, 574 (1894); Grandnorthern, Inc. v. West Mall Partnership, 359 N.W.2d 41, 44 (Minn. App. 1984); Scott v. Woolard, 12 Wash. App. 109, 529 P.2d 30, 31 (1974); Valley National Bank of Arizona v. Avco Development Co., 14 Ariz. App. 56, 480 P.2d 671, 676 (Ariz. App. 1971); Hansen v. G & G Trucking Co., 236 Cal.App.2d

481, 46 Cal.Rptr. 186, 197-98 (1965); Polito v. Chicago Title & Trust Co., 12 Ill.App.2d 57, 138 N.E.2d 710, 713 (1956); Rase v. Castle Mountain Ranch, Inc., 631 P.2d 680, 685 (Mont. 1981); Paurley v. Harris, 75 Idaho 112, 268 P.2d 351, 353 (1954); Pugh v. Gilbreath, 571 P.2d 1241, 1242-43 (Okla. App. 1977). Furthermore, under Utah law, reliance on a title report is not sufficient to satisfy the duty to inquire as to the rights of parties in possession of the property. Webster v. Knop, 6 Utah 2d 273, 312 P.2d 557, 560-61 (1957).

Lockhart was put on notice of a dispute between Hansen and the occupants of the Fairview property, the Lunds, but failed to make diligent inquiry, which would have led to discovery of the interest claimed by the Lunds under their agreement with Nelson. The known facts pointed directly toward the unknown, and this Court believes that Lockhart had a duty to inquire further. Having failed to make inquiry when it was its duty to do so, Lockhart was not a "good faith purchaser" entitled to protection of the recording act.

III.

Did the Hansens Defraud Lockhart Such as to Render Their Debt to Lockhart Nondischargeable?

A. Actual Fraud Under § 523(a)(2)(A).

Section 523(a)(2)(A) excepts from discharge debts for obtaining money, property, services, or an extension or renewal

of credit by false pretenses, a false representation, or actual fraud. The five elements of nondischargeable fraud under Section 523(a)(2)(A) are: (1) the debtor made the representations; (2) that at the time he knew they were false; (3) he made them with the intention and purpose of deceiving the creditor; (4) the creditor reasonably relied on such representations; and (5) the creditor sustained the alleged loss and damage as the proximate result of the representations having been made. See Hatch v. Mason (In re Mason), slip op., no. C-82-0440W (D. Utah Aug. 16, 1983) (per Winder, J.); In re Hames, 53 B.R. 868, 871 (Bkrtcy. D. Minn. 1985); Matter of Carpenter, 53 B.R. 724, 729 (Bkrtcy. N.D. Ga. 1985); In re Self, 51 B.R. 686, 690 (Bkrtcy. N.D. Miss. 1985); In re Santore, 51 B.R. 122, 123-24 (Bkrtcy. D. Mass. 1985); In re Leger, 34 B.R. 873, 876-77 (Bkrtcy. D. Mass. 1983); In re Firestone, 26 B.R. 706, 713 (Bkrtcy. S.D. Fla. 1982); Matter of Schnore, 13 B.R. 249 (Bkrtcy. W.D. Wis. 1981). A creditor who seeks to have a debt excepted from discharge under Section 523(a)(2)(A) must prove each element by clear and convincing evidence. Hatch v. Mason, supra, at 7.

Lockhart argues that by representing that they owned the Fairview property and failing to disclose the existence of the Lunds' claim, the debtors engaged in fraudulent conduct. The Court's findings of fact do not support this conclusion. First, Lockhart's evidence is not clear and convincing as to what verbal

representations were actually made by Hansen in connection with the loan. Second, no reliance was demonstrated by Lockhart; it relied not on the debtor's statements and representations but on his financial statement in making the loan. Therefore, the Court holds that Lockhart has failed to present clear and convincing evidence showing that Hansen made false representations, or that if made, the creditor relied on such representations.

B. False Financial Statements Under § 523(a)(2)(B).

Plaintiff next contends that the loan is excepted from discharge under Section 523(a)(2)(B). That section excepts from discharge certain debts incurred by using a false written statement respecting the debtor's or an insider's financial condition. In order to meet its burden of proof, a creditor must show by clear and convincing evidence that the debtor (1) obtained money, property, credit, or services, (2) by the use of a materially false statement in writing, (3) respecting the debtor's financial condition, (4) made with the intent to deceive, and (5) reasonably relied on by the creditor to advance the money, property, credit, or services. In re Harmer, unpublished memorandum opinion and order at 6, no. 82PC-0158 (Bkrtcy. D. Utah Oct. 24, 1984). See In re Coughlin, 27 B.R. 632, 635, 10 B.C.D. 266 (Bkrtcy. App. Pan. 1st Cir. 1983); Matter of Archer, 55 B.R. 174, 178, 13 B.C.D. 967 (Bkrtcy. M.D. Ga. 1985); In re Day, 54 B.R. 570, 572 (Bkrtcy. D. Mass. 1985); In re Blatz, 37

B.R. 401, 403 (Bkrtcy. E.D. Wis. 1984); In re Vandergrift, 35 B.R. 76, 78 (Bkrtcy. D. Md. 1983); In re Voeller, 14 B.R. 857, 858 (Bkrtcy. D. Mont. 1981).

1. Obtaining Money. In this case there is no question that Hansen submitted a financial statement to Lockhart respecting his financial condition and obtained a $30,120.00 loan as a result. Although Hansen personally received only $10,000.00 from the loan proceeds, § 523(a)(2)(B) does not require the debtor to actually procure the money for personal use. Where, as here, the debtor is a principal of a corporation or partnership and the debtor uses a false financial statement to induce a creditor to make a loan to the business, the debtor has "obtained money" within the meaning of § 523(a)(2)(B). In re Delano, 50 B.R. 613, 617 (Bkrtcy. D. Mass. 1985); In re Wade, 43 B.R. 976, 980-81 (Bkrtcy. D. Colo. 1984); In re Winfree, 34 B.R. 879, 883, Bankr.L.Rep. (CCH) ¶ 69,530 (Bkrtcy. M.D. Tenn. 1983); Matter of Holwerda, 29 B.R. 486, 489 (Bkrtcy. M.D. Fla. 1983). See 3 COLLIER ON BANKRUPTCY ¶ 523.08[1], at 523-40 (15th ed. 1985).

2. Material Falsity. It is undisputed that Hansen gave Lockhart a written financial statement in connection with the loan at issue here. The important question is whether the statement was materially false. An incorrect or erroneous financial statement is not necessarily materially false. In re Delano, supra, 50 B.R. at 617. The question of materiality

should be determined not solely on the basis of the size or seriousness of the misstatement, but by a comparison of the debtor's actual financial condition with the picture he paints of it. Id. at 618. A materially false financial statement is one which paints a substantially untruthful picture of the debtor's financial condition by misrepresenting information of the type which would normally affect the decision to grant credit. In re Denenberg, 37 B.R. 267, 271 (Bkrtcy. D. Mass. 1983). See Matter of Bogstad, 779 F.2d 370, 375, Bankr.L.Rep. (CCH) ¶ 70,881 (7th Cir. 1985). The information must not only be substantially inaccurate, but also must be information which affected the creditor's decision making process. In re Hunt, 30 B.R. 425, 440, Bankr.L.Rep. (CCH) ¶ 69,195 (M.D. Tenn. 1983). Thus it is appropriate to consider the creditor's use of the requested information both in connection with the element of "materiality" and the element of "reasonable reliance" when making a § 523(a)(2)(B) analysis. Id. at 440.

In the present case, plaintiff has established that the debtor's financial statement was materially false concerning his financial condition. Hansen listed the Fairview property as an asset worth $62,000.00, of which $56,000.00 represented the value of the Lunds' mobile home. That mobile home never actually became an asset of Hansen, who knew at the time he signed the financial statement that any claim he had to the property would

have to be resolved by litigation. The inclusion of the mobile home as an asset resulted in an over-statement of Hansen's assets by more than 50 percent. The materiality element has been satisfied. The misrepresentation of ownership of assets and the failure to divulge the true ownership interests in listed property constitutes material falsity for purposes of § 523(a)(2)(B). See In re Winfree, supra, 34 B.R. at 884.

3. Financial Condition. It is undisputed that the financial statement at issue here was Hansen's personal statement, and the representations contained therein concerned his personal financial condition.

4. Reasonable Reliance. The plaintiff must demonstrate that it actually relied on the debtor's false financial statement and that its reliance was reasonable under the circumstances. Hansen argues that Lockhart relied on its own title report, not the debtor's financial statement, to determine the ownership and value of the Fairview property, and Lockhart did not intend to hold the Hansens personally liable on the debt, but was looking to Draper for repayment of the loan. Lockhart, through the testimony of Manley, indicated that the Hansens as well as Draper would be liable on the note. Palfreyman testified that at the closing on the loan he explained to each of the obligors that they would be liable under the terms of the note. Further, in his deposition testimony, Hansen indicated that he knew Lockhart

could proceed against him personally on the note. Manley testified that Lockhart looked to the Hansens' asset picture because Natures Way did not qualify for the loan. In making the loan, Lockhart relied on its appraisal as well as the Hansens' financial statement, but not on the statements of Draper or Natures Way. As stated in the Court's findings, Lockhart did not know that the title to the property was in dispute or that Hansen contemplated a lawsuit to clear title, or that Hansen did not own the mobile home, or that his net worth was less than $55,000.00, or that some of the loan proceeds were obtained to pay legal fees and costs to clear title to the property. Had Lockhart known any of these facts, the loan would not have been approved. The Court finds the testimony of Manley and Palfreyman to be credible and convincing, and that Lockhart's reliance on the debtor's financial statement was reasonable.

The question remains of whether Lockhart's reliance was reasonable. The reasonableness issue in Section 523(a)(2)(B)(iii) determinations must necessarily be considered on a case by case basis. See Matter of Archer, supra, 55 B.R. at 178. The plaintiff in a nondischargeability action under § 523(a)(2)(B) is not required to prove that it relied solely on the false financial statement, so long as the statement is one of the items upon which it relied in making the loan. In re Blatz, supra, 37 B.R. at 405; Matter of Bonanza Import & Export, Inc.,

43 B.R. 570, 575 (Bkrtcy. S.D. Fla. 1984); In re Harmer, supra, at 11 and n. 10; In re Drewett, 13 B.R. 877, 880 (Bkrtcy. E.D. Pa. 1981). In this case, Lockhart's partial reliance on its appraisal report does not vitiate its reliance on the debtor's statement.

Courts have recognized four categories of cases where a creditor's reliance on a false financial statement is not reasonable: (1) where the creditor knows at the outset that the financial statement is not accurate; (2) where the financial statement contains insufficient information to present an accurate portrait of the debtor's financial condition for credit analysis; (3) where the creditor's own investigation reveals the likelihood that the debtor's financial statement is false or incomplete; and (4) where the creditor fails to independently verify any of the information contained in the financial statement. In re Harms, 53 B.R. 134, 140-41 (Bkrtcy. D. Minn. 1985); In re Price, 48 B.R. 211, 213, 12 C.B.C.2d 690 (Bkrtcy. S.D. Fla. 1985). A creditor, however, has no obligation to make an independent investigation of the loan applicant's financial condition, where the financial statement is neither inaccurate nor incomplete on its face, unless the creditor's normal business practice requires that such investigation be made. In re Day, 54 B.R. 570, 573 (Bkrtcy. D. Mass. 1985).

"[R]easonableness requires that representations must be found to be of such a character that a reasonably prudent person would rely on them. Such a standard fosters a responsible and careful use of solicited financial statements and discourages the 'spurious use' of such statements." Matter of Newmark, 20 B.R. 842, 862 (Bkrtcy. E.D. N.Y. 1982), quoting In re Magnusson, 14 B.R. 662, 668-69 n. 1, 8 B.C.D. 708 (Bkrtcy. N.D. N.Y. 1981). Reliance under Section 523(a)(2)(B)(iii) assumes a degree of causation. Thus, the reliance element will be satisfied if the proof establishes that the financial statement was the principal precipitant, the catalyst, for the loan, without which the loan would not have been made. In re Mutschuler, 45 B.R. 482, 492 (Bkrtcy. D. N.D. 1984). In the present case, Hansen's financial statement appeared accurate and complete on its face, and disclosed no facts that would put a reasonable creditor on notice that it should make further inquiry. There was no evidence that Lockhart had any reason to know or suspect that the debtor's ownership of the Fairview property and the value thereof as set forth in the financial statement were false or inaccurate. Lockhart conducted a credit investigation of Hansen and discovered that his ability to repay the loan was good, and obtained its own title report. Lockhart's conduct in this case was consistent with its normal business practices. Where the creditor has no reason to believe a debtor's estimates of the

value of assets is inaccurate, as was the case here, it does not act unreasonably in accepting those valuations. See In re Denenberg, supra, 37 B.R. at 272. Lockhart has established by clear and convincing evidence that it reasonably relied on Hansen's false financial statement.

5. Intent. Although a showing of unknowing inaccuracy is not sufficient to establish intent to deceive, actual knowledge of the falsity of the financial information is not required. A creditor can establish intent to deceive by proving reckless indifference to, or reckless disregard of, the accuracy of the information in the financial statement. In re Coughlin, supra, 27 B.R. at 632. As stated by Collier, "[i]t must be shown that the debtor's alleged false statement in writing was either knowingly false or made so recklessly as to warrant a finding that he acted fraudulently." 3 COLLIER ON BANKRUPTCY ¶ 523.09[5][6], at 523-69 (15th ed. 1985). Intent to deceive may be inferred where the debtor knew or should have known of the falsity of his statement. In re Delano, supra, 50 B.R. at 619; In re Denenberg, supra, 37 B.R. at 271. The fundamental purpose of the intent to deceive element is to assure that only the debtor who dishonestly obtained money be punished with nondischarge and that the honest, though mistaken, debtor is protected. In re Drewett, supra, 13 B.R. at 880 (Bkrtcy. E.D. Pa. 1981). Where the creditor has proved all of the other elements under

§ 523(a)(2)(B), the element of intent will be presumed and will not be defeated by the mere testimony of the debtor that he did not intend to deceive anyone. In re Harmer, supra, at 16-17; In re Drewett, supra, 13 B.R. at 880. Based on the magnitude of the inaccuracy contained in the financial statement and the doubtful nature of Hansen's interest in the Lunds' mobile home, the Court is persuaded that the debtor knew he was misrepresenting the value of his interest in the Fairview property. In light of the facts that Hansen paid nothing for the Lunds' mobile home and he knew that whatever claim of ownership he might have could only be resolved through litigation, his assertion that the Fairview property, with the Lunds' mobile home, was an asset of his worth $62,000.00 can only be attributable to intentional deceit.

CONCLUSION

This Court has carefully reviewed the evidence in light of the applicable authorities and concludes that as between defendant Lunds and plaintiff, the prior unrecorded interest of the Lunds prevails. The evidence presented failed to establish by clear and convincing evidence that the debtor's oral representations were fraudulent within the meaning of 11 U.S.C. § 523(a)(2)(A). However, plaintiff has carried its burden of proof under 11 U.S.C. § 523(a)(2)(B) and has shown by clear and convincing evidence that the debtor obtained money from plaintiff

by the use of a materially false statement made in writing, submitted to the plaintiff with intent to deceive, and upon which the plaintiff reasonably relied to its detriment.

Accordingly, the Court finds the debt to Lockhart non-dischargeable. Judgment shall be entered against the debtors in the amount of $30,132.00, together with interest thereon at the contract rate from February 11, 1980 until the date of judgment.

Plaintiff's attorney shall prepare and submit an appropriate form of judgment in accordance with Bankruptcy Rule 9021 and Local Rule 13. The foregoing constitutes this Court's Findings of Fact and Conclusions of Law as required by Bankruptcy Rule 7052.

DATED this 26 day of February, 1986.

BY THE COURT:

Glen E Clark

GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE