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~~Superior Court~~
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~~7/27/77~~

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
Central Division

(28)

COUNTER COPY - DO NOT REMOVE - ~~COPY FOR THE COURT~~

In re	:	Bankruptcy No. 80-00059
DORSAL DEE BATES and	:	
PATRICIA LYNN BATES, husband	:	
and wife,	:	
	:	Civil Proceeding No. 80-0046
Debtors,	:	
LARRY PEALE and SHARLYN	:	
PEALE, husband and wife,	:	
	:	
Plaintiffs,	:	MEMORANDUM DECISION AND
	:	ORDER
vs.	:	
	:	
DORSAL DEE BATES and	:	
PATRICIA LYNN BATES, husband	:	
and wife,	:	
	:	
Defendants.	:	

John W. Lowe representing the plaintiffs, Larry and Sharlyn Peale. Kenneth L. Rothery representing the debtors, Dorsal Dee and Patricia Lynn Bates.

On July 1, 1977, the debtors, Dorsal D. and Patricia L. Bates (hereinafter the Bates) sold a house located at 1730 Bismark Avenue, Richland, Washington, to the plaintiffs, Larry and Sharlyn Peale (hereinafter the Peales). Shortly after moving in, the Peales made application to the City of Richland for a permit to construct a swimming pool. At that time they were informed that the final building inspection had not taken place on their home. In the course of that inspection, several city building code violations were discovered that required correction before the necessary Certificate of Occupancy could be issued. The Peales hired a contractor to conform the home to the building code, then brought suit against the Bates in the Superior Court of the

State of Washington, Benton County, for their costs of reconstruction. A trial was held before the court and judgment was entered for the Peales in the amount of \$12,453.40 plus costs. The Bates subsequently filed bankruptcy in this Court. The Peales then filed a complaint objecting to the discharge of the judgment debt under 11 U.S.C §523(a)(2). Both parties have moved for summary judgment.

When a final, valid judgment has been issued, res judicata prevents litigation of the same cause of action between the same parties or their privies. When a bankruptcy court is litigating the dischargeability of a previously rendered state court judgment, however, res judicata has no application. See Brown v. Felson, 442 U.S. 127 (1979). But, if issues necessary to the original judgment have been fully litigated in the previous suit pursuant to the same standards as would be applied by the bankruptcy court, collateral estoppel will apply to bar relitigation of those issues. See Brown v. Felson, 442 U.S. at 139, n.10; Cutler v. Tebbs, No. 79-00965 (D. Utah Aug. 19, 1980).

In the case before the Court, the state court rendered a judgment in favor of the Peales, finding that the "defendants materially misrepresented the condition of said residence proximately causing the plaintiffs damage." Findings of Facts and Conclusions of Law, No. 79-33396 (Sup. Ct. Wash. 1979). Whether this material misrepresentation rises to the level of a nondischargeable false representation must be determined in order to ascertain the extent of the application of collateral estoppel.

A preliminary question arises in whether the debtors obtained money or property as meant in 11 U.S.C. §523(a)(2). The state court judge found that the claimed value of the house was \$62,500.00, the purchase price, but that the actual value of the house was \$12,453.40 less than that amount.

Therefore, the debtors sold a house worth less than the money they received for it. As such, they obtained money or property pursuant to their representations with a resulting loss to the creditor. See 3 COLLIER ON BANKRUPTCY ¶523.08[1] (15th ed. 1979).

Next, the standard used in the state court for a finding of misrepresentation must be compared with the standard used by this Court in resolving Section 523(a)(2) issues. Under Washington State Law, fraudulent representations were defined in Lawson v. Vernon, 38 Wash. 422, 80 P. 55, 561 (1905), as when "a person states as true as of his own knowledge material facts susceptible of knowledge to one who relies and acts thereon to his injury." In that case, a buyer was led to believe he was buying a certain parcel of land when in fact what was actually sold to him was the adjoining parcel. The elements of misrepresentation in tort include a false representation of a material fact, made knowingly or with a reckless disregard for the truth, followed by reasonable reliance and injury. See 37 AM.JUR.2d Fraud and Deceit §§41, 188 (1968). See also Kohl v. Taylor, 62 Wash. 678, 114 P. 874 (1911) (false statement of a material fact); Woonsocket Rubber Co. v. Loewenberg, 17 Wash. 29, 48 P. 785 (1897) (inducement to part with value).

In the bankruptcy law, the new Code has been in effect such a short time that few cases have been published using Section 523. Former law has been largely incorporated in Section 523(a)(2) and, therefore, existing case law provides precedent for establishing the standard to be applied under the new law. See In re Jones, 6 B.C.D. 68 (W.D.Va. 1980).

Standards used by bankruptcy courts in Section 17(a)(2) cases, former 11 U.S.C. §35a(2), may differ from tort law in the degree of intent required. Some courts consider reckless disregard for the truth sufficient; others require the presence of intentional wrongdoing or moral turpitude.

In In re Beard, 5 B.C.D., 680 (M.D.Tenn. 1979), the debtor had misrepresented the amount of mileage on a car he sold to the plaintiff. The court stated that actual intent to defraud was necessary to a finding of nondischargeability under Section 523(a)(2). Less stringent standards were applied by the court in In re Houtman, 3 B.C.D. 1403 (9th Cir. 1978) when it accepted the state court's definition of misrepresentation, holding that "either actual knowledge of the falsity of a statement, or reckless disregard for its truth, satisfies the scienter requirement for nondischargeability of a debt." Id at 1407. This Court applied the same standard in In re Davies, No. 78-00723 (D. Utah Jan. 11, 1980).

Therefore, the standards as applied in this Court and in Washington state court proceedings for determining misrepresentation are essentially the same: misrepresentation of a material fact, made knowingly or recklessly without regard for the truth, which was justifiably relied on, and produced injury.

In the case before the Court, the state court found that the debtor materially misrepresented the condition of the house, proximately causing the plaintiff's injury. The debtor was "aware at the time plaintiffs purchased the residence, that the residence did not meet the requirement of the City Building Code," yet he "represented to the plaintiff . . . that the defendants had constructed the residence in accordance with the applicable Building Code of the City of Richland." Findings of Facts and Conclusions of Law, No. 79-33396 (Sup. Ct. Wash. 1979). That reliance on this misrepresentation was reasonable can be inferred from the court's finding that apart from the "minor and obvious" deficiencies in the residence, the debtor represented that the house had been constructed in a workmanlike manner. Many of the code violations were

problems not apparent to the untrained eye and would not be recognized by the ordinary home buyer. For example, stairs and landing, windows, and a bathroom floor and bathtub all had to be removed and either repaired or replaced. Although the doctrine of caveat emptor, or let the buyer beware, is generally applicable to the sale of real estate, it does not "bar the right of a purchaser to rely on the statements and representations of material facts made by the vendor to induce the purchaser to enter into the contract for the purchase of land." 37 AM.JUR., Fraud and Deceit §239, at 319 (1968). The Peales' reliance on Bates' statement concerning the quality of construction, considering the difficulty of spotting the defects and their right to believe statements of fact, was reasonable.

The debtor has aptly pointed out that the state court judgment makes no mention of fraud or intent to deceive. However, fraud is only one of three possible grounds available in Section 523(a)(2). The Washington court found that "material misrepresentation" was present, and, as previously noted under Washington law, this is substantially equivalent to a Section 523(a)(2) false representation. In any case, under Washington law, the state court's findings could constitute fraud. As stated in Pike v. Parallel Film Distributing, Inc., 74 Wash. 2d 218, 443 P.2d 804, 807 (1968),

Misrepresentations of material facts made either knowingly or recklessly and with an intent to induce the plaintiff to part with his money . . . and plaintiff, acting reasonably, was induced by the misrepresentations . . . then the plaintiff has shown actionable fraud. (emphasis supplied).

Thus, at least under Washington law, the findings of fact could support a finding of fraud as well as of material misrepresentation. Therefore, as the debtor's motion for summary judgment is based upon the lack of a finding of fraud or an intent to deceive, it must be denied.

As an alternative holding, the Washington court found that "the defendants negligently constructed the residence purchased by the plaintiffs proximately causing the plaintiffs damage." Findings of Facts and Conclusions of Law, No. 79-33396 (Sup. Ct. Wash. 1979). The fact that there exists this alternative ground for decision does not undermine the court's specific finding of material misrepresentation as a proximate cause of the damage.


As the Washington state court found liability based on misrepresentation and as misrepresentation as defined by Washington law is the same as a false representation under Section 523(a)(2), collateral estoppel applies to bar further litigation in this Court. The Peales' motion for summary judgment must, therefore, be granted.

ORDER

The debtors' motion for summary judgment is denied.

The plaintiffs' motion for summary judgment is granted.
Plaintiffs shall prepare judgment.

DATED this 3 day of October, 1980.



Ralph R. Mabey
United States Bankruptcy Judge