

1968

Pioneer Finance & Thrift Company, a Corporation v. Dahl Ray Powell and Bonnie Rae Powell, His Wife : Reply To Respondent's Brief In General

Utah Supreme Court

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Recommended Citation

Reply Brief, *Pioneer Finance & Thrift v. Powell*, No. 11133 (Utah Supreme Court, 1968).
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**IN THE SUPREME COURT
OF THE
STATE OF UTAH**

**PIONEER FINANCE & THRIFT
COMPANY, a corporation,**
Plaintiff-Respondent,

vs.

**DAHL RAY POWELL and
BONNIE RAE POWELL, his wife,**
Defendants-Appellants.

**APPELLANTS' REPLY BRIEF
TO RESPONDENT'S CROSS APPEAL
TO RESPONDENT'S BRIEF IN REPLY**

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FILED
MAY 14 1968
Clerk, Supreme Court, Utah

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Case No.
11133

REPLY TO RESPONDENT'S BRIEF IN
GENERAL

RESPONDENT'S BRIEF FAILS TO OVER-
COME THE DEFENSE AGAINST COLLECTION
OF THE POWELLS' NOTE AS THOSE DE-
FENSES ARE SET FORTH IN THEIR BRIEF
IN CHIEF.

The Powells' Brief in chief asserts four sepa-
rate substantive law defenses against collection of
their note by Respondent, Pioneer. These are: AR-
GUMENT TWO, Fraud in the Inducement; ARGU-
MENT THREE, Failure of Pioneer to Act in Good

Faith and Avoid Unconscionable Contracts; ARGUMENT FOUR, Failure of a Condition Precedent; and ARGUMENT FIVE, Lack or Failure of Consideration.

It is the Powells' hope that this Court will find for them on all four grounds. However, a valid defense against collection of the note by Pioneer is stated in *each* of the foregoing substantive law defenses or *any combination* of them.

The Powells' Brief in chief cites many cases where courts found that buyers were not required to repay money they had borrowed from finance companies to purchase goods which the seller of the goods failed to deliver to the buyer. In these cases, the courts found that the finance companies were not holders in due course, even though the paper had been negotiated to them or purchased by them for value because those courts also found that those finance company claimants had been put on notice of, or were implicated in a fraud being perpetrated by the seller.

To assume that those cases are relevant here *only* if this Court also finds Pioneer guilty of fraudulent participation in Stanley's scheme widely misses their legal impact. Such a finding of fraud on Pioneer's part is by no means necessary to make the cited cases relevant to this case.

Pioneer is not a holder in due course. Pioneer has the status of a "non-holder", not because of fraud on its part, but simply because Pioneer is a "direct

party" in the contract with the Powells. Pioneer is not a purchaser for value, nor has the note on which it sues been negotiated. Pioneer is not a holder in due course by definition and as a matter of law.

This Court's decision in *Scow v. Guardtone*, 18 Utah 2d 135, 417 P. 2d 643 (1966) is illustrative of cases where courts have deprived lenders of holder in due course status by a finding of fraud or knowledge on their part. The Plaintiff in *Scow*, Prudential Federal Savings & Loan, claimed to be an innocent purchaser for value of Scow's conditional sale contract from Guardtone. Though a conditional sale contract is not a negotiable instrument, yet by virtue of Section 70A-9-206 of the Utah Uniform Commercial Code (or its predecessor in the NIL) an innocent purchaser for value of a conditional sale contract is clothed with substantially all the attributes of a holder in due course of a negotiable instrument.

There was no question in *Scow* whether Guardtone delivered the goods to Scow nor whether Prudential was a purchaser for value of the Scow contract. The nub of the question posed to this Court in *Scow* seems to have been whether Prudential was "innocent." For the various reasons cited in that opinion, this Court found that Prudential was sufficiently careless or involved in Guardtone's fraud as to strip of its "innocent" purchaser status.

Once this Court had decided Prudential was not entitled to the extraordinary protection provided for an innocent purchaser, the result was that Pruden-

tial could not prevail in its collection suit against Scow, however, no finding of knowledge or fraud on the part of Pioneer is needed in this case to confer on the Powells all of the legal defenses here asserted by them as provided by the rules of ordinary contract law.

The lack of understanding of the cases cited in the Powells' brief in chief is illustrated by Respondent's Brief where at page 13 it states:

"Defendants' cases cited in their brief such as *Commercial Credit Corp. vs. Orange County Machine Works*, 34 Cal. 2d 766, 214 P. 2d 819, and *Mutual Finance Company vs. Martin*, 63 So. 2d 649, 44 ALR 2d 1, are not pertinent to the instant matter. In those cases the financing institution was found to have participated in the transaction (the sale) to the extent that the court held they were not a holder in due course of the paper which they purchased."

Respondent fails to make the further inevitable legal conclusion that since the finance companies in the above cases were found not to be holders in due course (because of their fraudulent participation) those finance companies were thereby placed in the same boat in which Pioneer now finds itself because Pioneer also is not a holder in due course by definition.

Respondent's brief at page 14 states:

"In cases where contracts or notes have been *sold* or *assigned*, the courts have held that the financing institution must have acted in bad

faith in order that the defense of *failure of consideration or of fraud in the inducement prevail against them.*" [emphasis added]

We agree. Where instruments have been *sold or assigned*, fraud or bad faith must be found to deprive note owners of the special protection provided for holders in due course, against the defenses of failure of a condition precedent, or failure of consideration.

In the course of making its argument that estoppel should be invoked against the Appellants, Respondent cites *Thorp Finance Company v. LeMire*, 264 Wis 220, 58 NW 2d 641, 44 ALR 2d 189 (1953) as authority for the proposition that since the debtors signed a paper acknowledging that the merchandise promised by the seller was already in the buyers' possession, the buyers were estopped to assert failure of consideration to defend against the finance company suit on its note. This interpretation of *LeMire* seems to be at variance with what the Wisconsin Supreme Court actually said at 44 ALR 2d 195:

"The trial court made a statement in the record after counsel for the plaintiff had moved for a directed verdict explaining the court's reasons for granting such a motion. In such statement the trial court declared that it would be a violation of the parol evidence rule to permit LeMire to prove that the furniture being purchased by him from Stoltz had never been delivered *when the contract itself recited such delivery.* [emphasis added]

“The learned trial court was in error in his conclusion that the parol evidence rule would preclude LeMire from proving the non-delivery of the furniture . . .”

Pioneer even admits at page 20 of its Brief that “it is unlikely that Plaintiff relied on the literal language” of the Chattel Mortgage to the effect that the furniture was in possession of the Powells, but asserts it did rely on representations that the loan was to purchase the furniture on Stanley’s list. What did happen? Pioneer’s check was endorsed by Mr. Powell and delivered to Stanley’s agent in Pioneer’s office in the presence of Pioneer’s personnel (see Def. Dep. p. 17-18) to pay for the furniture on Stanley’s list, which furniture was also listed on the Chattel Mortgage. Also at page 13 of its brief, Pioneer states that the check was made payable to Stanley “to insure that the funds were actually used for the intended purpose.” Pioneer cannot now assert it did not intend to have Stanley receive their check.

Respondent seems to feel its position is strengthened if it can establish that Stanley’s promise to deliver the furniture was somehow in the “indefinite future” (Respondent’s Brief, p. 6). That the Powells expected the furniture to be delivered immediately after they delivered Pioneer’s check to him is clearly demonstrated by the fact that they made numerous requests for the furniture (Def. Dep. p. 25) during the six or seven week period which intervened between signing the note and posting of the bankruptcy notices on the Stanley Furniture Company door.

In view of all the legal and equitable circumstances involved in this case, Appellant vigorously resists Respondent's request for attorney's fees on this Appeal and on the contrary, asks that their own be paid by the Respondent.

REPLY BRIEF TO RESPONDENT'S CROSS-APPEAL

THE TRIAL COURT WAS CORRECT IN RULING THAT RESPONDENT HAD FAILED TO STATE A CLAIM OF FRAUD AGAINST THE APPELLANTS WHICH WOULD BAR DISCHARGE IN BANKRUPTCY UNDER THE FEDERAL BANKRUPTCY ACT.

Section 17 (b) (2) of the Bankruptcy Act [11 U.S.C. 35 (a)] provides that a discharge in bankruptcy will release a bankrupt from all his provable debts except such debts as:

“(2) are liabilities for obtaining money or property by false pretenses or false representations or obtaining credit upon a materially false statement respecting his financial condition or caused to be made or published in any manner whatsoever *with intent to deceive . . .*” [emphasis added]

The United States Supreme Court interpreted this section of the Bankruptcy Act in *Gleason v. Thaw* 236 US 558, 35 S Ct 287, 59 L ed 717, which is also quoted at 133 ALR 436 stating as follows:

“. . . It does not except from discharge debts created by obtaining credit through concealment of insolvency and present inability to

pay. It excepts from discharge 'Liabilities for obtaining money or property by false pretenses or false representations.' Within the meaning of that statute then, there were no false pretenses, no false representations here. There was merely the obtaining of credit *without full disclosure, with the knowledge that if full disclosure had been required, credit might well not have been given, but that was all.* A remedial statute, like that of bankruptcy intended for the relief of debtors, *must*, insofar as denial of discharges and therefore of relief, *be construed strictly* so that all debts except those coming exactly within the exception will stand discharged." [emphasis added]

In an annotation titled "What constitutes false representations in application for loan within provision of Bankruptcy Act rendering liability for obtaining money by false pretenses or representations non-dischargeable" the following summary statement will be found at 17 ALR 2d 1209:

"The reported decisions make it clear that, if § 35 of the Bankruptcy Act is to prevent a bankrupt's discharge from liability for a loan, the latter must be shown to have secured the loan by false representations of such character as to meet the judicial requirements for legal fraud — that is, the bankrupt's representations must have been material and false in fact, *must have been made with an intent to deceive and defraud*, and the creditor must have believed, acted, and *relied* upon them to its prejudice. The representation must be of an existing fact or circumstance, not merely a

promise or statement of intention . . .” [emphasis added]

In amplification of the elements which must be proved in Utah to constitute the offense of obtaining money by false pretenses [76-20-8 UCA (1953)] this Court in *State v. Timmerman* 88 U 481, 478, 55 P 2d 1320, 56 P 2d 1354 lays down the following rules of proof which are required:

“Under this section [76-20-8 UCA] the following elements *and* proof of them must concur, viz.: (1) There must have been false or fraudulent representations or pretenses; (2) the representations must have been made *knowingly and designedly*; (3) there must have been *a concurring intent to cheat or defraud the person to whom the false or fraudulent representations or pretenses were made*; (4) something of value must have been obtained because of the false or fraudulent representations or pretenses; and (5) the party to whom the false or fraudulent representations or pretenses were made must have parted with something of value in reliance upon the false or fraudulent representations or pretenses, believing them to be true.” [emphasis added]

Pioneer makes much in its Brief and Cross Appeal of a play on words to the effect that the Appellants deceived the Respondent in that the Powells represented to Pioneer that they were borrowing money in the amount shown on Stanley’s handwritten list to pay for the furniture on that same handwrit-

ten list when in fact, according to Pioneer, the Powells really only “loaned” the money to Stanley on Stanley’s promise to give them “free” the furniture he listed.

While Pioneer’s Brief recites some indication from the deposition that there was some confusion, particularly in the mind of Mrs. Powell as to the difference between buying and paying for furniture and lending money in return for getting furniture “free,” further reading of the deposition leaves no doubt that Mr. Powell thought he was borrowing the money from Pioneer to buy the furniture on Stanley’s list.

Pioneer’s Brief at page 7 recites the following answer given by Mr. Powell:

“A. Well, the way he [Stanley] told us that he was borrowing money on our credit and in return he was giving us the furniture for him lending us his credit or him using our credit.”

If the questions and answers immediately following the foregoing (Def. Dep. p. 26) had also been quoted, additional light would have been shed on Mr. Powell’s understanding of the transaction:

“Q. You didn’t really feel like you were buying furniture?”

“A. Yes, we thought we were buying furniture.

“Q. And what did you expect to do in the event Stanley wasn’t able to pay for the furniture?”

"A. Well, I figured we would pay for the furniture as long as we had the furniture if he didn't make the payments. [The Powells' intention to pay if Stanley failed to pay is also asserted in their Deposition on page 38.]

"Q. So it would be correct to say that you thought you were purchasing furniture?

"A. Yes.

"Q. And that in any event if Stanley could not make the payments you intended to make the payments?

"A. Yes, that's right.

"Q. Did it ever occur to you that maybe Stanley might not deliver the furniture to you?

"A. No, it didn't. We was going mostly by our friend. [David Hunt] He was the one that got us in on the deal and I knew him all my life and trusted him and he had received his furniture and Stanley had made all the payments on it and if Stanley had come up on the street and told me of such a deal I wouldn't have gone for it but where my friend got me into it I fell for it."

Mrs. Powell also seemed to consider she was borrowing the money to pay for the furniture on Stanley's list as shown by the following exchange (Def. Dep. p. 37) :

"Q. Mrs. Powell, it was your understanding, was it, that you were buying furniture from Mr. Stanley?

“A. We was receiving some furniture, yes.

“Q. And that you were borrowing money from the finance company to pay for that furniture?

“A. Yes, and that he would be making the payments.”

That there was no intention on the part of the Powells to defraud Pioneer is further made clear by the fact that they paid over to Pioneer the money for a payment they received from Stanley. It seems unlikely they would have paid over his money if they had intended to defraud Pioneer. Their lack of intention to defraud is further made clear by the fact that in their deposition the Powells reaffirmed the truthfulness of the financial statement they submitted to Pioneer and on which Pioneer relied in making the loan.

Much is made of the fact that the Powells failed to tell Pioneer about Stanley's promise to make the payments. Though the Powells did not know why Stanley advised them not to tell Pioneer they certainly did not think their failure to tell of Stanley's program was in any way fraudulent or harmful to Pioneer.

At page 10 of the Powells' Deposition the following colloquy between Mr. Swan and Mr. Powell will be found:

“Q. Did you feel at this time that there was anything morally wrong or illegal about this deal?

"A. Well, No.

"Q. You felt if someone would pay off this note and chattel mortgage and you can get free furniture for it, why no one's hurt, is that right?

"A. Right."

In the colloquy which then ensued, it developed that Mr. Powell had made numerous loans from finance companies, and that he was familiar with procedures and the time usually required for him to secure a loan. At page 20 of his deposition, Mr. Powell states:

"Q. So you were pretty well familiar with their procedure?

"A. Yes.

"Q. And it is on that basis that you say this loan went through in a shorter span of time?

"A. Yes. Before we have went to a finance company and filled out information and we have had to wait a day or so before they would tell us whether our loan was O.K. before we even went there."

In Defendants' Deposition p. 32, Mrs. Powell clearly states that she thought the finance company already knew about Stanley's arrangement:

"Q. (By Mr. Swan) When he [Stanley] cautioned you that way did that bother you?

"A. Yes, it did.

“Q. Up to that point had you assumed that he and the finance company knew exactly what was going on?

“A. I think they did.

“Q. After that time did you begin to wonder if the finance company knew exactly what was going on?

“A. Well, like my husband said, that was the shortest loan we have ever had taken out because others, they have really checked us but this one they didn't to our knowledge.

“Q. At the one time he said to you ‘Don't tell the finance company that I am making the payments,’ wasn't that a red flag to you that the finance company didn't have the whole story?

“A. Well, yes, but on the other hand our friend [David Hunt] said that some finance companies did know what was going on. He didn't name any finance companies specifically but he said there was some of them that did know.”

Actually, the Powells made no false representations or pretenses to the Respondent. It is true that they did not discuss the fact that they intended to receive money from Stanley to make the payments but the law seems clear that merely failure to disclose information which is not asked for cannot constitute a false pretense or representation except perhaps in a fiduciary relationship. It seems clear also from the pleadings, the Affidavit of Pioneer's Manager, and from the Deposition, that *Respondent re-*

lied in making the loan on the written and oral credit information supplied by the Appellants, the truth of which credit information was reasserted in the Depositions and has never been challenged by Pioneer. Respondent cannot now be sustained in its assertion that it relied in making the loan on Appellants' failure to advise them that Stanley had agreed to supply the funds for the payments.

The simple fact is that Pioneer bargained for and received a note signed by the Powells in reliance on the Powells' credit statement, but since Pioneer is not a holder in due course, failure of Stanley to deliver the furniture is a defense under contract law against Pioneer's collection of the Note. Pioneer cannot now cure its legal inability to collect on the note by the cry of "fraud" where none exists.

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