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National Finance Company of Provo v. Dallas E. Daley and Flora Daley : Brief of Appellants

Utah Supreme Court

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William G. Fowler; Attorney for Appellants;

E. Morgan Wixom; Attorney for Respondent;

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IN THE SUPREME COURT
of the
STATE OF UTAH

FILED

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**NATIONAL FINANCE COM-
PANY OF PROVO,**

Plaintiff and Respondent,

v.

**DALLAS E. DALEY and
FLORA DALEY,**

Defendants and Appellants.

Supreme Court, Utah

No.

9618

UNIVERSITY UTAH

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BRIEF OF APPELLANTS

**Intermediate Appeal from the Order of the
2nd Judicial District Court for Weber County
Hon. Parley E. Norseth, Judge**

**William G. Fowler
1101 Newhouse Building
Salt Lake City 11, Utah
Attorney for Appellants**

**E. Morgan Wixom
1010 First Security Bank Bldg.
Ogden, Utah
Attorney for Respondent**

TABLE OF CONTENTS

	Page
STATEMENT OF THE NATURE OF THE CASE	1
DISPOSITION IN LOWER COURT	2
RELIEF SOUGHT ON APPEAL	2
STATEMENT OF THE FACTS	2
ARGUMENT	3
POINT I. DEFENDANTS ARE EN- TITLED, AS A MATTER OF LAW, TO JUDGMENT ON THE PLEADINGS, IN- ASMUCH AS THE JUDGMENT FORMING THE BASIS OF PLAINTIFF'S COM- PLAINT IS A DISCHARGEABLE OBLI- GATION BY VIRTUE OF THE BANK- RUPTCY ACT.	3
A. PLAINTIFF IS PRECLUDED FROM INTRODUCING EVIDENCE OF FRAUD WHERE ACTION BASED ON PRIOR JUDGMENT, AND WHERE PRIOR PROCEEDINGS DE- VOID OF PROOF TO ESTABLISH THE NONDISCHARGEABLE CHAR- ACTER OF THE OBLIGATION.....	4
B. TO PERMIT PLAINTIFF TO INTRO- DUCE EXTRANEOUS EVIDENCE NOT RELATED TO THE PLEAD-	

	Page
INGS IN EITHER PROCEEDING WOULD DEFEAT THE PURPOSE OF THE BANKRUPTCY ACT AND CAUSE DEFENDANTS UNREASON- ABLE HARASSMENT.	11
CONCLUSION	15

AUTHORITIES CITED

Bronx County Trust Co. v. Cassin (1939)	170
Misc. 962, 10 N.Y.S. 2d 986	10
In re Caldwell, D.C., 33 F. Supp. 631, 635	13
Citizens Mutual Auto Ins. Co. v. Gardner (1946)	
315 Mich. 789, 24 N.W. 2d 410	10
In re Donahy, D.C.N.Y., 45 F. Supp. 758	14
Fillmore Commercial & Savings Bank v. Kelly,	
62 Utah 514, 220 Pac. 1064, 1066	13
In Re Forgay (U. S. Dist. Ct. Utah, 1956)	140
F. Supp. 473	12
Jacobs v. Beatty, 165 Ohio St. 596, 138 N.E. 2d	
657	10
Lyons v. Lyons (Utah, 1949), 206 P.2d 148	14
Matter of Benoit, 124 App. Div. 142, 108 N.Y.	
Supp. 889	14
Ohio Finance Co. v. Greene, (Ohio, 1956), 146	
N.E. 2d 739	10
Personal Industrial Loan Corp. v. Forgay (10th	
Cir., 1956), 240 F.2d 18	13
Re Rhutassel (1899, D.C.) 96 Fed. 597	12

	Page
Rice v. Guider (1936) 275 Mich. 14, 265 N.W. 777	9
State Finace Co. v. Murrow (10th Cir., 1954), 216 F.2d 676	14
Scott v. Corn (1929, Tex. Civ. App.) 19 S.W. 2d 412, cert. denied in 281 U.S. 736, 74 L.ed. 1151, 50 S. Ct., 249	11
United Mercantile Agencies v. Williams, 87 Ohio App. 273, 94 N.E. 2d 572	9

TEXTS CITED

6 Am. Jur., Bankruptcy, § 816, p. 1031	7
Annotation, 170 A.L.R. 368, 374	6
8 C.J.S., Bankruptcy, § 587	8
8 C.J.S., Bankruptcy, p. 1522	8
Collier Bankruptcy Manual, Second Edition, p. 208	7
1 Collier on Bankruptcy, 14th Edition, p. 1623	7

STATUTES CITED

11 U.S.C. § 36 (P.L. No. 87-621, 86th Cong. 2nd Sess. (July 12, 1960), 74 Stat. 408)	4
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IN THE SUPREME COURT
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STATE OF UTAH

NATIONAL FINANCE COM-
PANY OF PROVO,

Plaintiff and Respondent,

v.

DALLAS E. DALEY and
FLORA DALEY,

Defendants and Appellants.

No.
9618

BRIEF OF APPELLANTS

STATEMENT OF THE NATURE OF THE
CASE

This is an action upon a judgment obtained by plaintiff in the Ogden City Court, wherein defendants have interposed the affirmative defense that the prior judgment is a provable debt discharged in bankruptcy.

DISPOSITION IN LOWER COURT

Defendants moved the lower court for a judgment upon the pleadings. The lower court denied defendants' motion, and defendants have petitioned for intermediate appeal from said order denying the motion for judgment on the pleadings. This Honorable Court has granted the petition for intermediate appeal.

RELIEF SOUGHT ON APPEAL

Defendants seek a reversal as a matter of law of the order of the lower court denying their motion for judgment on the pleadings.

STATEMENT OF FACTS

On May 29, 1958, defendants made a loan from plaintiff, a loan company, in the sum of \$577.69, delivering a promissory note as evidence of the indebtedness. On January 7, 1959, a judgment was obtained by plaintiff, and against defendants, in the Ogden City Court, upon a complaint alleging a cause of action upon said note.

Subsequently, on May 23, 1959, both defendants filed in the United States District Court for the District of Utah, their voluntary petitions in bankruptcy, and were duly adjudicated bankrupts. The schedule of liabilities, filed with each petition, set forth the obligation to the plaintiff, and notice was given in accord-

ance with law. On December 28, 1959, defendant Flora Daley was granted her discharge in bankruptcy, and on February 8, 1960, defendant Dallas E. Daley was granted his discharge in bankruptcy.

Thereafter, on February 17, 1961, plaintiff filed the instant action upon its judgment obtained in the Ogden City Court. The complaint is based solely upon the judgment, making no reference whatsoever to fraud or misrepresentation. Defendants answered denying the judgment, and setting up as an affirmative defense their discharge as bankrupts, averring that the judgments, in any event, would be a provable and dischargeable obligation by virtue of the Acts of Congress relating to bankruptcy.

By way of a pleading entitled "Reply," plaintiff asserts that defendant borrowed money from the plaintiff, and that the same was obtained fraudulently. It is further asserted that the judgment, the gravamen of the present action, was based upon the promissory note given plaintiff at the time of the loan.

Fraud was not the basis of the original action in the Ogden City Court, nor is it the basis of the instant complaint.

ARGUMENT

DEFENDANTS ARE ENTITLED, AS A
MATTER OF LAW, TO JUDGMENT ON THE

PLEADINGS, INASMUCH AS THE JUDGMENT FORMING THE BASIS OF PLAINTIFF'S COMPLAINT IS A DISCHARGEABLE OBLIGATION BY VIRTUE OF THE BANKRUPTCY ACT.

A. PLAINTIFF IS PRECLUDED FROM INTRODUCING EVIDENCE OF FRAUD WHERE ACTION BASED ON PRIOR JUDGMENT, AND WHERE PRIOR PROCEEDINGS DEVOID OF PROOF TO ESTABLISH THE NON-DISCHARGEABLE CHARACTER OF THE OBLIGATION.

Section 17 of the Acts of Congress relating to bankruptcy, provides that a discharge in bankruptcy will release a bankrupt from all of his provable debts, except such as "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, * * * " (11 U.S.C. § 36). The foregoing incorporates into the Act by amendment (Pub. L. No. 86-621, 86th Cong., 2nd Sess. (July 12, 1960), 74 Stat. 408) the result previously reached by case law. Whether plaintiff can bring this doctrine to bear upon defendants depends upon the genesis of the action.

This case must not be confused with those where the plaintiff commences an action upon the promissory note, or even upon the alleged fraud, and proceeds in the trial of the matter, in the first instance to offer competent evidence of fraud. There is no allegation or evidence of fraud apparent in the first action which produced the judgment, nor do we have any allegation of fraud, nor can any properly be made, in the present action on the judgment. The original judgment, assuming that the entire record of those proceedings can be inspected, shows that the action was brought by plaintiff upon a promissory note, and that judgment was taken upon the promissory note. Neither the action, proceedings, pleadings, proof or judgment make reference to any fraud or misrepresentation such as would establish the nondischargeable character of the obligation. This fact is uncontroverted and must be in mind when the authorities are examined.

It can be agreed that the transformation of a non-dischargeable obligation into a note or judgment does not thereby render the obligation dischargeable in bankruptcy, and it is agreed that the court may look through the new form of indebtedness and reveal its true character, where that is the fact. Cases supporting this proposition are distinguishable from the instant case in that only *one* step intervened between the original debt, claimed to be nondischargeable, and the effect of the discharge, that step being the giving of the note in satisfaction of the obligation, or the obtaining of a judgment to enforce the debt.

Two steps intervene in the instant case. We not only have a promissory note given by the defendants, but in addition we have a judgment on the note. Indeed, it can be stated that a *third* step is involved, as plaintiff is here endeavoring, not to enforce his judgment, but to bring a wholly new action on the former judgment. Even assuming that the court could look behind a judgment, standing alone, or behind a note, standing alone, plaintiff asks that this court look behind the judgment and then behind the note. Whether the court can now examine evidence having no relation to the judgment and not properly raised by the pleadings in either action is the only issue presented here.

Although there is some sparse authority to the contrary, the overwhelming number of courts and responsible authorities have concluded that the nondischargeable character of the original obligation may be shown only if the record of the judgment or the proceedings in which it was obtained discloses its nondischargeability, but not otherwise. This view is supported by cases collected in an annotation at 170 A.L.R. 368, at 374, which summarizes the dominant view to conclude that the nondischargeable character of the original obligation may be shown only by what appears on the judgment record or the record of the proceedings culminating in the judgment; so that, if nothing appears on the judgment record or the record of the proceedings which would establish the nondischargeability asserted by the plaintiff, then the judgment will be discharged.

This rationale is supported by the most respected authority on bankruptcy, Collier, who observes in *Collier Bankruptcy Manual*, Second Edition, at page 208, as follows:

“Of course, if the judgment is based on a record which contains no evidence of false representations, it should be dischargeable. (Citing cases.)”

Fuller treatment of the problem in *Collier on Bankruptcy*, 14th Edition, Vol. 1, p. 1623, deals with our precise issue:

“Where, however, a liability has been prosecuted to judgment, the record is decisive as to the character of the claim upon which the judgment is founded, and cannot be affected by the introduction of parol evidence except in the case of ambiguity. (Citing cases). In order that a judgment based upon a fraudulent representation may be excepted from the operation of a discharge, the record in the action must show fraud and deceit were the ‘gist and gravamen’ of the action. (Citing cases)”.

Again, this generally accepted proposition governing the instant case finds support in 6 *Am. Jur., Bankruptcy*, § 816, page 1031, which makes the following conclusion:

“It appears that the majority of the cases adopt the view that the nondischargeable character of the original obligation may be shown notwithstanding the recovery of a judgment on the note which evidenced the original obligation, by resort to the record of the judgment or of the proceedings in which it was obtained. By the

weight of authority, although it is permitted to go behind the judgment for the purpose of ascertaining the character of the original obligation, the scope of the showing in this respect is restricted to the record of the judgment or of the proceedings in which it was obtained. If nothing appears on that record showing that the original obligation was of a character excepted from the discharge in bankruptcy, the judgment is dischargeable, and, conversely, if that record discloses the nondischargeable character of the original obligation, the judgment will not be discharged."

To the same effect, see also 8 *C.J.S.*, *Bankruptcy*, § 587, as follows:

"Where the claim or demand against which a discharge in bankruptcy is asserted is in the form of a judgment and the issue involved is whether the judgment comes within a class excepted from the operation of the discharge, the entire record of the action in which such judgment was recovered is admissible and may be considered in the determination of the question, especially if the nature of the cause in which the judgment was obtained is not apparent from the judgment itself. *Beyond such record the court may not go, evidence outside the record not being admissible, certainly not to contradict the record. This rule confining the evidence to the record is applicable where fraud in the incurring of the indebtedness is asserted to save the judgment from the discharge.*" (Emphasis supplied.)

At page 1522, in 8 *C.J.S.*, it is observed:

"Where it does not appear from the judgment itself just what the nature of the action was,

whether it was obtained in an action for fraud such as will bring it within the exception herein will be determined from an inspection of the entire record on which the judgment was based. Beyond the record, however, the court may not go; hence, where the judgment recites that the cause of action was based on an account, the judgment creditor cannot go beyond the judgment and prove that the transaction out of which it arose was fraudulent, so as to avoid the effect of a discharge."

The foregoing encyclopedic and text references are uniform in their analysis of the prevailing reasoning, and will not permit plaintiff, in the case at bar, to now open the litigation far beyond the original judgment, and even beyond the note itself.

In a recent Ohio decision in proceedings to enforce a judgment taken on a promissory note, the record being silent as to the facts and circumstances under which the indebtedness was created, and a defense of bankruptcy being raised, it was *held* that evidence outside of the record is inadmissible to show that the judgment debtor's obligation is one that is excepted from the operation of a discharge in bankruptcy (*United Mercantile Agencies v. Williams*, 87 Ohio App. 273, 94 N.E. 2d 572). The distinction between the situation where the proceedings leading to the judgment are absolutely devoid of evidence tending to show nondischargeability and the situation where the earlier proceedings do contain such evidence is well articulated in *Rice v. Guider* (1936) 275 Mich. 14, 265 N.W. 777,

and a subsequent Michigan decision, *Citizens Mutual Auto Ins. Co. v. Gardner* (1946) 315 Mich. 689, 24 N.W. 2d 410. In the *Rice* case, *supra*, the court observed:

“A judgment is but an adjudication upon a record. Plaintiff could go back of the judgment but not back of the record. The judgment record does not bring plaintiff's cause of action within any exception to the discharge in bankruptcy.”

The *Insurance Company* case, *supra*, distinguished the *Rice* case in arriving at a different result upon the ground that the record of the proceedings leading to the judgment disclosed actual facts establishing the nondischargeable character of the debt. To the same effect, see *Ohio Finance Co. v. Greene*, (Ohio, 1956), 146 N.E. 2d 739; and, *Jacobs v. Beatty*, 165 Ohio St. 596, 138 N.E. 2d 657.

The facts in the present case are identical in all material respects to those in *Bronx County Trust Co. v. Cassin* (1939) 170 Misc. 962, 10 N.Y.S. 2d 986, where the court was asked to look beyond the pleadings and into the circumstances of the transaction to find grounds opposed to the discharge in bankruptcy. In refusing to do this, the court concluded upon grounds of practicability and the weight of authority that it should not attempt to determine whether the transaction involved a different claim from that of the cause of action which resulted in the judgment.

And, in a case where the enforcement of a judgment upon a note was sought against the bankrupt,

and the complaint in that suit showed no allegation of fraud whatever, but that the cause of action was entirely one for debt on the note, and the judgment so reflected, it was held that the bankrupt was entitled to enjoin the enforcement of the judgment, and the judgment creditor was precluded from offering extraneous evidence of fraud (*Scott v. Corn* (1929, Tex. Civ. App.) 19 S.W. 2d 412, certiorari denied in 281 U.S. 736, 74 L.ed. 1151, 50 S. Ct., 249).

**B. TO PERMIT PLAINTIFF TO INTRO-
DUCE EXTRANEOUS EVIDENCE
NOT RELATED TO THE PLEADINGS
IN EITHER PROCEEDING WOULD
DEFEAT THE PURPOSE OF THE
BANKRUPTCY ACT AND CAUSE DE-
FENDANTS UNREASONABLE HAR-
ASSMENT.**

The rule has a sound social and legal basis. To permit creditors the dubious privilege of reopening their judgments against a bankrupt to offer extraneous and foreign evidence having no relationship or bearing to the cause of action, an election already made, would frustrate and defeat the purposes of the bankruptcy act. Carried to its logical extreme, the position urged by plaintiff conceivably could compel the bankrupt to relitigate and re-defend countless varieties of actions, all of which ordinarily are dischargeable. It is submitted that to do so is inconsistent with the orderly conduct of legal proceedings, and certainly is not consonant with

the relief afforded by the Bankruptcy Act, which is intended to relieve the debtor from the constant worry and pressure of creditors. (See *Re Rhutassel* (1899, D.C.) 96 Fed. 597).

Illuminating on this aspect of the problem is In *Re Forgay* (U.S. Dist. Ct. Utah, 1956) 140 F. Supp. 473, where the United States District Court for the District of Utah, enjoined a judgment creditor from executing upon his judgment against a discharged bankrupt. In that case, a default judgment was obtained during the pendency of the bankruptcy proceedings upon a complaint alleging a promissory note, and an additional allegation of fraudulent misrepresentation. Although fraud was averted, the court observed that the "action is *founded upon the debtor's note*" and the creditor "took a *judgment on the note*, which included interest and attorney fees as provided in the note." In granting a permanent injunction against the judgment creditor, who tried to set up the purported evidence of fraud in the securing of the loan, the court chided the loan company which "had personal notice of the bankruptcy proceedings but entered no appearance, filed on proof of claim and interposed no objections to discharge," concluding:

"Misconduct on the part of creditors, if encouraged, portends the disintegration of the bankruptcy system and its orderly administration. There is no justification for federal courts to abdicate their authority in state courts, jeopardize the usefulness of the Bankruptcy Act,

permit the confusion and harassment of the honest debtor, give advantage to the unscrupulous creditor and contribute to the lack of public faith in the proceeding itself."

In affirming the *Forgay* decision, the 10th Circuit Court of Appeals made the following observations:

"We are dealing here with a finance company engaged in making small loans to debtors generally in distress when they apply for such loans. As observed by the Court in *In re Caldwell*, D. C., 33 F. Supp. 631, 635, 'If creditors, with their expert credit men, were as diligent in investigating the responsibility of applicants for credit and as prudent in bestowing it, as they are persistent and sometimes oppressive in attempting to collect after the indebtedness has been incurred, there would be fewer claims of fraud and attempts like this to defeat a discharge in bankruptcy,' and we might add by bypassing the bankruptcy court and in going into a non-record state court" (240 F'2d 18, 20).

The court further stated that although a reference was made to fraud in the complaint, more was required, citing *Fillmore Commercial & Savings Bank v. Kelly*, 62 Utah 514, 220 Pac. 1064, 1066, for the following:

" 'It is elementary that fraud must be alleged by distinctly pleading the facts constituting the fraud. Mere epithets or conclusions or general charges * * * are not good unless accompanied with a statement of facts to sustain it * * * . It is necessary to show not only what the fraud was, and that injury has been sustained, but also the connection of the fraud with the alleged

damaged, so that it may appear * * * whether the one might have resulted directly from the other.' "

See also *State Finance Co. v. Murrow* (10th Cir., 1954), 216 F.2d 676; and *In re Donahy*, D.C.N.Y., 45 F. Supp. 758.

In a Utah case treating with a similar aspect of dischargeability in bankruptcy, the court permitted an examination behind a divorce judgment to ascertain the nature of an award relating to alimony (*Lyons v. Lyons* (Utah, 1949), 206 P.2d 148. In the *Lyons* case it was apparent that the award was ambiguous and in need of clarification, which is not the situation in the instant case, as here there is no contention that fraud was the basis of either action. In the *Lyons* case the Utah Supreme Court cited as authority for its ruling 2 *Freeman on Judgments*, 5th Ed., 1176, and this author recognizes the distinction between our situations, where, at page 1177, he comments:

"But while the form of the action is not controlling in determining whether the case falls within the exception of the statute, *nevertheless this fact must appear from the record* (citing *Matter of Benoit*, 124 App. Div. 142, 108 N.Y. Supp. 889.) and where the action is on contract it is not permissible to show the debt had its inception in fraud."

CONCLUSION

The result sought by defendants in their motion for judgment on the pleadings is manifestly fair and in harmony with the purposes of the Bankruptcy Act. It cannot go unnoticed that plaintiff has never complained about fraud until an answer is filed to a law suit commenced long after the bankruptcy cases are closed. No claim of fraud was made in the suit on the note; none was made in the bankruptcy proceeding; and, none was made in the instant complaint. To permit plaintiff to throw in a claim of fraud to support an action upon a note, and where the damages are bottomed on contract, would be to grossly distort the litigation beyond the sensible boundaries furnished by the pleadings, and compel the defendants to defend an action upon a theory never properly presented to the Ogden City Court or to the Second District Court. Accordingly, the defendants respectfully ask that the action of the Second District Court denying their motion for judgment on the pleadings be reversed.

Respectfully submitted,

WILLIAM G. FOWLER
1101 Newhouse Building
Salt Lake City, Utah
Attorney for Defendants
and Appellants