

1962

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

Utah Supreme Court

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William G. Fowler; Attorney for Appellants;

E. Morgan Wixom; Attorney for Respondent;

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Case No. 9618

In the Supreme Court of the State of Utah

NATIONAL FINANCE COMPANY
OF PROVO,

Plaintiff and Respondent,

vs.

DALLAS E. DALEY and
FLORA DALEY,

Defendants and Appellants.

RESPONDENT'S BRIEF

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

E. MORGAN WIXOM
1010 First Security Bank Bldg.
Ogden, Utah
Attorney for Respondent

WILLIAM G. FOWLER
1101 Newhouse Building
Salt Lake City 11, Utah
Attorney for Appellants

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Clerk, Supreme Court, Utah

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In the Supreme Court of the State of Utah

NATIONAL FINANCE COMPANY
OF PROVO,

Plaintiff and Respondent,

vs.

DALLAS E. DALEY and
FLORA DALEY,

Defendants and Appellants.

RESPONDENT'S BRIEF

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

STATEMENT OF THE KIND OF CASE

This is an action brought by the plaintiff-respondent upon a judgement made and entered by the Ogden City Court, the defendants-appellants having been adjudicated bankrupts and discharged in bankruptcy after the entry of the Judgment and prior to the filing of the suit upon such judgment, the plaintiff-respondent replying that such judgment is excepted from discharge in bankruptcy as a result of the false representations of the defendants in incurring the debt which was merged into the judgment.

DISPOSITION IN LOWER COURT

Defendants-appellants moved the lower court for a judgment upon the pleadings. The District Court denied such motion and defendants have brought this intermediate appeal.

RELIEF SOUGHT ON APPEAL

Defendants-appellants seek a reversal, as a matter of law, of the order of the District Court denying their motion for judgment on the pleadings. Plaintiff-appellant seeks to have such order affirmed.

STATEMENT OF FACTS

This matter comes before the above entitled Court upon an intermediate appeal from an Order of the District Court of Weber County, State of Utah, denying defendants Motion for Judgment upon the pleadings.

There has been no evidence taken in the case, and the appeal is based entirely upon the record and pleadings filed in the District Court.

On the 29th day of May, 1958, the defendants made, executed and delivered to the plaintiff their written promissory note in the principal sum of \$577.69, when such note was not paid, the plaintiff brought an action in the City Court of Ogden City, Weber County, State of Utah, against the defendants which suit was based upon the promissory note. Thereafter, on the 7th day of January, the said Ogden City Court entered a Default Judgment against each of the defendants for the sum of \$668.12, such amount being the amount of the note plus the accrued interest thereon to the date of the Judgment and Court costs.

On or about the 17th day of February, 1961, the plaintiff filed this action in the District Court of Weber County, State of Utah, alleging in its Complaint that the plaintiff had on the 7th day of January, 1959, in an action filed in the City Court of Ogden City, Weber County, State of Utah, entitled National Finance of Provo, plaintiff -vs- Dallas E. Daley and Flora Daley, defendants, Civil No. 29232, a Judgment was duly made and entered by the City Court in favor of the plaintiff and against the defendants therein for the sum of \$668.12 together with interest thereon at the rate of eight (8%) per annum from the date thereof and that such Judgment remains wholly unpaid and unsatisfied. The plaintiff by its Complaint in the District Court action sought a new judgment for the sum of \$668.12, interest and Court costs.

To such complaint, the defendants filed their answer alleging that on the 23rd day of May, 1959, the defendants, and each of them, filed their petition in the United States Court for the District of Utah and were duly adjudicated bankrupts; that the plaintiff's claim was scheduled therein and that the defendants were discharged as bankrupts in accordance with the acts of Congress relating to bankruptcy.

Defendants by their answer are claiming that the claim upon which plaintiff's complaint was based has been discharged in bankruptcy and that such bankruptcy is a bar to the prosecution of the above entitled action.

At the time of the pre-trial of the above entitled action, the Court authorized plaintiff to file its Reply and plaintiff did file its Reply in this action alleging in part as follows:

“Plaintiff alleges and states that if the defendants or either of them secured an order of discharge in bankruptcy or have been adjudicated bankrupts, that such discharge or such adjudication in bankruptcy does not and will not operate to discharge or release the obligation sued upon herein, for the reason that such obligation constitutes a liability for obtaining money or property by false pretenses or false representations within the meaning of Section 17a (2) of the Bankruptcy Act, in that the defendants on or about the 29th day of May, 1958, obtained a loan of money from the plaintiff in the sum of \$577.69, with interest upon \$300.00 thereof at the rate of 3% per month and upon \$277.69 thereof at the rate of 1% per month from the date of such loan, and defendants delivered to plaintiff their promissory note as evidence thereof, which loan was secured through the making and publishing of a materially false statement of defendant’s indebtedness upon which the plaintiff relied in making said loan to the defendants; that in said statement, defendants misrepresented the amount of their indebtedness to other creditors and failed to disclose, but rather concealed, obligations owing to various other creditors in an amount in excess of the sum of \$2,066.00 over and above the amount of the indebtedness disclosed by such statement; that the misrepresentations of the defendants were material and were relied upon by the plaintiff to its damage and prejudice.

“That the plaintiff, on or about the 5th day of

December, 1958 brought suit against the defendants upon the aforesaid loan from plaintiff to defendants in an action filed in the City Court of Ogden City, Weber County, State of Utah, entitled National Finance Company of Provo, plaintiff, -vs- Dallas E. Daley and Flora Daley, defendants, Civil No. 20232, and did, upon the 7th day of January, 1959, in said action obtain a judgment in said Court in favor of this plaintiff and against the defendants herein for the sum of \$668.12, with interest at the rate of 8% per annum from the 7th day of January, 1959, which judgment is the judgment now sued upon in this action."

For the purpose of this appeal, the plaintiff admits that the defendants were adjudicated bankrupts subsequent to the entry of the judgment in the action brought by the plaintiff against the defendants in the City Court of Ogden City, Weber County, State of Utah, and that the claim of the plaintiff, merged into such Judgment, was duly scheduled in such bankruptcy proceedings and that the defendants and each of them were subsequently discharged in bankruptcy. Plaintiff also admits that the suit brought in the City Court of Ogden City was brought upon the note and that in the City Court action there were no allegations in the pleadings that the loan evidenced by such note was obtained through false pretenses or false representations or fraud.

The issue presented upon this appeal is whether or not the District Court may now look beyond the record and examine the facts relating to the manner in which

the original obligation was incurred to determine whether or not the adjudicated indebtedness is one excepted from the discharge in bankruptcy.

A R G U M E N T

POINT I

DEBTS INCURRED BY FALSE REPRESENTATIONS ARE NOT DISCHARGED IN BANKRUPTCY.

Liabilities for obtaining money or property by false pretenses or false representations are declared among the debts not affected by a discharge of bankruptcy. Section 17a (2) of the Bankruptcy Act (11 U.S.C.A. 35) provides as follows:

"Debts not affected by a discharge."

"A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether in full or in part, *except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations . . .*" (emphasis supplied)

As the United States Supreme Court said in *Pepper vs. Litton*, 308 U. S. 295, 84 Lawyers Edition 28, public policy demands that the "act should be liberally construed so as to prevent the discharge in bankruptcy of a liability which would not exist but for the fraudulent conduct of the bankrupt."

A false financial statement given to obtain a loan of money or to obtain property under an installment sales contract will present the basis for a determination that the obligation arising thereby is not dischargeable

within the meaning of Section 17a (2) of the Act. While there would seem to be no hard and fast rule as to what constitutes a false representation in a financial statement, the omission, concealment, or understatement of liabilities, when material, is considered to be sufficient.

The instances in which state courts have held that an understatement of liabilities in a financial statement constituted "false representations" are innumerable. Typical are Railroad Employee's Person Loan Co. vs. Dillon (1939) 123 N.J.L. 31, 7 A. (2nd) 855; Watts et.al. vs. Ward (Mass. App. Div. N. District.) 29 B.T.L. 179; Workingmen's Loan Association vs. Leslie Magoon, Mass. App. Div. Boston Muni Ct. Dist. No. 157683; Personal Finance Co. of Waterbury vs. Robinson, (1941) Supreme Ct. Trial and Special Term, Madison County 27 N.Y.S. (2d) 6; Personal Finance Co. of New York vs. Ralph L. Vosburg, (S. Ct. N.Y. St. Lawrence, Jan. 13, 1942); Chester-Neal Co. vs. Generazzo, (1942) 20 N.J. Mise. 296, 26 A (2nd) 867; also profitable to examine are other factual situations held to be within Sec. 17a (2). To be noted in this connection are Symmes vs. Rollins, (1928) 39 Ga. App. 546, 176 S.E. 516; Gregory vs. Williams, (1920) 106 Kan. 819, 189 P. 932; Mathewson vs. Naylor, (1937) 18 Cal. App. (2d) 741, 64 P. (2d) 979; Grespi & Co. vs. Griffen, (1933) 132 Cal. App. 526, 23 P. (2d) 47; Donahue vs. Conley, (1927) 85 Cal. App. 15, 258 P. 985; Guernsey-Newton Co. vs. Napier, (1929) 151 Wash. 318, 275 P. 724.

POINT II

EVIDENCE OF FRAUD IS NOT A DEPARTURE FROM A SUIT BASED UPON A JUDGMENT

It is proper in avoidance of the defense of a discharge in bankruptcy to show such matters as will put the case without the operation of the discharge of bankruptcy. To illustrate, the false representations made by way of a financial statement or declaration of indebtedness are asserted, not to change the cause of action from contract to fraud, but to prevent its being barred by the bankrupt in bankruptcy. When the affirmative defense of discharge in bankruptcy is asserted, the plaintiff has opportunity to meet that defense and to show that it does not constitute a bar to the action. The plaintiff is not attempting to state a different cause of action. This was emphasized by the Supreme Court of Kansas in the case of Gregory vs. Williams, 106 Kan. 819, 198, P. 932, 933:

“ . . . The fraud was set up in the reply, not as a cause of action against the defendant, but to avoid the defense that had been pleaded . . . The action continued as an action on the promissory note. The reply did not constitute a departure from the cause of action alleged in the bill of particulars . . . ”

To demonstrate further, this theory of approach was favorably recognized in Kiser vs. Gerald, (1920) 17 Ala. App. 648, 88 So. 49, 50. There the plaintiff instituted action both on common counts for goods sold, and on promissory notes. The answer asserted a discharge in bankruptcy. In reply, the plaintiff set up the false financial statement of the defendant, which was demurred on the ground that it constituted a departure by setting up a new cause of action in fraud and deceit. The demurrer was sustained by the lower court and the

plaintiff appealed. The appellant court, in reversing the trial court, said:

“When the bankrupt’s discharge is pleaded to an action on such a debt, it is good replication that the debt was created by fraud, etc., and the court in which the action is brought has jurisdiction to try the issue. Broadnax vs. Bradford, 50 Ala. 270; Blackman vs. McAdams, 131 Mo. App. 408, 111 S. W. 599 Jacobson vs. Horne 52 Miss. 186; Argall vs. Jacobs, 87 N.Y. 110, 41 Am. Rep. 357. There are many authorities cited in the foregoing adjudicated cases to the same effect. The case of Strauch vs. Flynn, 108 Minn. 313, 1 22N.W. 320, cited in appellee’s brief, while sustaining appellee’s contention, is opposed to the great weight of authority as well as to good reason. The replication does not set up a new cause of action declared on, but simply alleges facts exempting the plaintiff’s claim from the operation of the Bankruptcy Act. The court erred in its ruling on the demurrer, and its judgment is reversed . . .”

Some courts have held that a reply or replication is not necessary on the theory that the plaintiff is presumed to deny affirmative allegations and statements in the defendant’s answer. It was so held in the case of Delatour vs. Lala, (1929) 12 La. App. 314, 125 So. 138, the third syllabus of which case reads:

“Where defendant, in action on open account, alleged relief from plaintiff’s claim by discharge in bankruptcy, plaintiff held entitled to show

without further pleading that his debt was excepted from discharge under Bankruptcy Act. Sec. 17 (11 U.S.C.A. Sec. 35) because it was a liability incurred by false pretenses and false representations, since plaintiff is presumed to deny affirmative allegations of defendant's answer and, then when special defense is made, there is no necessity resting upon plaintiff to expressly challenge facts on which it is based."

See also Rules 7(a) and 8(d), Utah Rules of Civil Procedure hereinafter set out.

In this connection, see also *Young vs. Grau*, (1884) 14 R.I. 340, 342, involving an action in debt on a New York Judgment where the Supreme Court of Rhode Island took occasion to comment.

"A debt created by fraud is not void but voidable only and therefore a creditor may assert both the debt and the fraud at the same time, so long as he asserts the fraud to avoid not the debt but the discharge. The bankrupt act recognizes this when it allows the creditor to prove the debt for a dividend, and nevertheless, relieves it from the discharge, for the debt is provable as a debt, not as a tort."

Particularly satisfying is the case of *Stewart vs. Emerson* (1872) 52 N.H. 301, 310, 311, where an action was brought in assumpsit for the price of goods sold. The defendant pleaded a discharge in bankruptcy to which the plaintiff asserted the fraud of the defendant. The court said:

"The plaintiff declares upon a promise of the

defendant to pay for goods sold, and, if he maintains his action, he maintains it upon the contract of sale affirmed by him. When a party has an election between two inconsistent rights or remedies - - for instance, when he can rely upon a contract or renounce the contract and rely upon fraud - - and has knowledge of all the facts material to be known in making a choice, his selection of one may be a renunciation of another. *Butler vs. Hildreth*, 5 Met. 49. *But the plaintiff in this case avers the fraud of the defendant, not as the plaintiff's cause of action but as a refutation of the defendants alleged defense of discharge.* The plaintiff claims to recover damages, not for the defendant's fraud, but for the breach of his promise to pay for the goods bought; and in the replication he alleges the fraud not as the ground on which his action rests, *but to show that there is no ground on which the defendant's discharge can be applied to this debt.* He asserts, not that the sale was void for fraud, but that, by reason of fraud, the debt was not discharged under the bankrupt act. He asserts the fraud, not for the purpose of rescinding the contract, but to show that the defendant has not been relieved from his obligation to perform his part of the contract." (emphasis supplied)

POINT III

THE PLAINTIFF, IN AN ACTION UPON A JUDGMENT OR NOTE, IS NOT REQUIRED IN HIS COMPLAINT TO ALLEGE FRAUD OR MISREPRESENTATION OF THE DEBTOR TO EXCEPT THE

DEBT SUED UPON FROM THE BAR OF THE
DEBTOR'S DISCHARGE IN BANKRUPTCY AND
MAY SHOW FRAUD OR MISREPRESENTATION
BY WAY OF REBUTTAL.

In pleading under the contract theory, an action is brought as in an ordinary case of suit in contract or assumpsit. In the particular case before the Court, the suit has been brought upon the Judgment of the plaintiff against the defendants. When the defendants assert bankruptcy as a defense, the plaintiff, in rebuttal to the defense of bankruptcy, may show that the obligation is not dischargeable in bankruptcy under Section 17 of the Bankruptcy Act, for the reason that the debt was incurred by false pretenses of false representations within the meaning of that section. In other words, it is proper in avoidance of the defense of a discharge in bankruptcy to show such matters as will put the case without the operation of the discharge such as false representations made by way of a materially false financial statement. Such evidence is offered not to change the cause of the action from contract to fraud but to show that the debt is not discharged in bankruptcy.

That this is good pleading would appear obvious, for the defense of bankruptcy is one which must be pleaded (Rule 8(c) U.R.C.P.) and which until asserted is not in issue. When asserted the plaintiff has opportunity to meet that defense and to show that it does not constitute a bar to the action. *Symmes vs. Rollins*, (Ga.) 146 S.E. 42, *Collier on Bankruptcy*, 13th Ed., page 616; *Zimmern vs. Blount*, 238 Fed. 740; *Fidelity & Casualty Co. of New York vs. Golombosky*, (Conn.) 50 A. 2d 817.

It should be kept in mind that, as hereinbefore discussed, the plaintiff in so doing is not attempting to state a different cause of action.

Rule 7(a) Utah Rules of Civil Procedure, relating to pleadings allowed, provides as follows:

“Pleadings. There shall be a complaint and an answer; and there shall be a reply to a counterclaim denominated as such; an answer to a cross-claim, if the answer contains a cross-claim; a third party complaint, if leave is given under Rule 14 to summon a person who was not an original party; and there shall be a third party answer, if a third party complaint is served. *No other pleading shall be allowed, except that the court may order a reply to an answer or a third party answer.*” (emphasis supplied)

Thus, under the Utah Rules of Civil Procedure, the plaintiff is not permitted to reply to the affirmative defense of discharge in bankruptcy. And such affirmative defense is “deemed as denied or avoided.” Rule 8(d) U.R.C.P.

A California court has adopted the same approach. An action was pleaded on the contract in *Crespe & Co. vs. Griffen et al.* (1933) 132 Cal. App. 562, 23 P. 2d 47, in case before the District Court of Appeals, 4th District of California; there was no allegation of fraud asserted. The defendant had been discharged in bankruptcy. An appeal was taken from a judgment in favor of the plaintiff, the defendant contending that the proof of misrepresentation and fraud was admitted in evidence when it had not been pleaded. The California court, in af-

firming the judgment in favor of the plaintiff, said:

“ . . . In the instant case the original obligation is on a promissory note. Fraud was included and incidental to the creation of that obligation. That incident was properly urged without pleading to avoid the plea of discharge in bankruptcy. Section 462 of the Code of Civil Procedure provides: ‘Every material allegation of the complaint, not controverted by the answer, must, for the purposes of the action, be taken as true; the statement of any new matter in the answer in avoidance or constituting a defense or counter claim must, on the trial, be deemed controverted by the opposite party.’ ”

A similar practice obtains in New York. In *Frey vs. Torrey*, (1902) 75 N.Y. Sup. 40, 43, *aff’d* 175 N.Y. 501, it is thusly described:

“Subdivision 4 of 549, Code Civ. Proc. . . . (now sec. 826 of C.P.A. Subdivision 10) classifies an action to recover a debt induced by fraud as an action on contract . . . The claimant may sue on contract and if the discharge in bankruptcy be pleaded, he may, in rebuttal, show that the debt was created by fraud, not to change his cause of action from contract to fraud, but to prevent its being barred by this discharge in bankruptcy . . . ”

As distinguished therefrom, the action was in contract in the case of *Argall vs. Jacobs, et. al.*, (1881) 87 N.Y. 110, 114, and there, the court said:

“ . . . It was not needful that the plaintiff should

allege fraud in his complaint. It was no part of his cause of action. It was needful only for him to prove it, not as a part of his cause of action, but as an answer to the affirmative defense set up. (Composition of creditors and discharge in bankruptcy subsequent to the date of the note)

“In this cause the plaintiff could sue the defendants directly for the fraud or for the purchase price of the goods; and in either case he would have been obliged to surrender the notes upon the trial; or he could use, as he did, suit upon the notes; and in either case proof of the fraud would be an answer to the bankruptcy discharge . . .”

The decision in the Argall case was followed in the much more recent case of Personal Finance Company of Waterbury vs. Robinson, et al (1941) Supreme Court Trial and Special Term, Madison County, 27 N.Y.S. 2d 6, 9. The status and development of the New York law is most capably analyzed and considered by Justice Deyo in this case. He declared:

“The question was specifically passed upon in Argall vs. Jacobs 87 N.Y. 110, 41 Am. Rep. 357. There, as in the case at bar, an action was brought upon a promissory note and no fraud was alleged in the complaint. The answer, as here, set up as an affirmative defense, a discharge in bankruptcy. Upon the trial, the plaintiff was permitted to give evidence tending to show that his debt was ‘created by the fraud of the bankrupt,’ which was the wording of the statute at that time. The appellate court held this to

be proper and affirmed the judgment for the plaintiff, saying at page 113 of 87 N.W. 'But it is further contended on the part of the defendants that the plaintiff cannot have the benefit of the limitation contained in the act of 1867, because he did not base his cause of action upon the alleged fraud, but upon the promissory notes, making no allusion to the fraud in his complaint. It is not provided that no cause of action for fraud shall be discharged, but that "no debt created by fraud" shall be discharged. These promissory notes were debts of the defendants, and the plaintiff was induced by the fraud of the defendants to sell goods to them and take their notes therefor, and hence these debts were created by their fraud within the meaning of the Bankruptcy Act. It was not needful that the plaintiff should allege the fraud in his complaint. It was no part of his cause of action. It was needful only to him to prove it, not as part of his cause of action, but as an answer to the affirmative defenses set up.

"A similar decision was reached in Frey vs. Torrey, 70 App. Div. 166, 75 N.Y.S. 40, affirmed 175 N.Y. 501, 67 N.E. 1082, subsequently overruled on other grounds in Tindle vs. Berkett, 183 N.Y. 267, 76 N.E. 25, affirmed 205 U.S. 183, 27 S Ct. 493 51 L. Ed. 762, on the authority of Crawford vs. Burke, 195 U.S. 176, 25 S. St. 9, 49, L. Ed. 147. In this case, the Court said at page 171 of 70 App. Div., at page 43 of 75 N.Y.S.' 'The claimant may sue on contract, and if the

discharge in bankruptcy be pleaded he may, in rebuttal, show that the debt was created by fraud, not to change his cause of action from contract to fraud, but to prevent its being barred by the discharge of bankruptcy.

“Although the proof submitted by the defendant is not as full and complete as might be desired, it is sufficient to indicate that there is a genuine question of fact to be determined relative to the character of the claim asserted. That being the case, the matter cannot and should not be summarily decided on this motion (*Munoz & Co., vs. Savannah Sugar Refining Corp.*, 118 Misc. 24, 193 N.Y.S. 422, regardless of defects and omissions in the pleadings (*Erzinger vs. Lieberman*, 218 App. Div. 847, 219 N.Y.S. 28), for such defects may conceivably be removed by amendment at the trial or sooner. *Curry vs. Mackenzie*, 239 N.Y. 267, 146 N.E. 375.”

The recent Utah case of National Finance Company of Utah vs. Valdez, 11 Utah 2d 339, 359 P. 2d 9, is an action against a bankrupt upon a note and chattel mortgage which the bankrupt alleged represented a debt which had been discharged in bankruptcy, the Supreme Court of the State of Utah held that the loan evidenced by a promissory note had been obtained by fraud and was excepted from discharge in bankruptcy and that the plaintiff could maintain the action upon the note and was not confined to an action for fraud, the Utah Court stating as follows:

“In considering the question before us, it must

be remembered that a discharge in bankruptcy is neither a payment nor the extinguishment of debts. It is simply a bar to their enforcement by legal proceedings. Thus, the note here sued upon was not extinguished by the bankruptcy, but is still in existence and its collection enforceable if excepted from a discharge under Section 17 of the Bankruptcy Act.

"We believe that a loan, evidenced by a promissory note which is obtained by fraud is excepted from a discharge in bankruptcy. This being so, the plaintiff here could maintain its action on the note and was not confined to an action based upon fraud. In Section 17 it is not provided that a cause of action for fraud is not discharged, but that no debt created by fraud shall be discharged.

"The defendant's final contention is that the plaintiff, by electing to rely upon the contract, had waived the issue of fraud. This contention, for the reasons heretofore set forth, is without merit."

POINT IV

IN A SUIT UPON A JUDGEMENT, THE COURT MAY AND SHOULD RECEIVE EVIDENCE BEYOND THE RECORD AND EXAMINE THE FACTS AND CHARACTER OF THE ORIGINAL OBLIGATION TO DETERMINE WHETHER OR NOT THE JUDGMENT DEBT IS ONE EXCEPTED FROM THE DISCHARGE IN BANKRUPTCY.

The introductory comment to the Annotation at

170 A.L.R. 368, cited by Appellant states as follows:

“Frequently, a debt which was nondischargeable in its original form has been supplemented by a form of obligation, such as a note or a judgment, which is not in any of the classes of debts excepted from the operation of the discharge, and is, presumptively at least, dischargeable unless the court may go behind the note or the judgment and ascertain the character of the original obligation as one not dischargeable. *In such cases, the courts have pretty uniformly held that the transformation of the evidences of the original nondischargeable obligation does not render it dischargeable, as the court may look through the new form and discover that the indebtedness in its inception was of a character nondischargeable.* (emphasis supplied)

“Thus, it has been generally held that a claim which is not dischargeable under the provision of the bankruptcy Act is not rendered dischargeable by the recovery of a judgment thereon. In such case the judgment itself is not dischargeable. *Parker vs. Whittier* (1899) CCA 1st 91 F 511, 1 Am. Bankr. 621 (writ of certiorari denied in (1898) 147 US 802, 32 L. Ed. 1187, 19 S. Ct. 887); *Thompson vs. Judy* (1909; CCA 6th) 169 F. 553, 22 Am. Bankr. 154; *Peters vs. United States* (1910; CCA 4th) 177 F 885, 24 Am. Bankr. 206 (writ of certiorari denied in (1909) 217 US 606, 54 L Ed 900, 30 S. Ct. 696). *Whoerle vs. Gancini* (1910) 158 Cal. 107, 109 P. 888. *Moody vs. Muscegee Mfg. Co.* (1910) 134 Ga 721, 68 SE

604, 20 Ann Cas. 301. Oberreich vs. Foster (1909) 148 Ill. App. 297 (affirmed in (1907) 230 Ill. 525, 82 NE 858; Halsy vs. Jordan (1910) 155 Ill. App. 144. State ex rel. Wheatley vs. Beck (1911) 175 Ind. 312, 93 NE 664. Wade vs. Clark (1879) 52 Iowa 158, 2 NW 1039, 35 Am Rep 262. Brown vs. Hannagan (1911) 210 Mass. 246, 96 NE 714 27 Am. Bankr. 294. Simpson vs. Simpson (1879) 80 NC 332. Chambers vs. Kirk (1914) 41 Okla 696, 139 P. 986, 32 Am. Bankr. 175. Young vs. Grau (1884) 14 RI 340.”

It was held in Gehlen vs. Patterson, (1928) 83 N.H. 328, 141 A. 914, that the fact that an action has been instituted on a promissory note, rather than on the fraud which was practiced in obtaining the loan for which the note was given, and the fact that a judgment has been recovered in such action and an action has been insituted on the judgment, *does not preclude the judgment creditor from showing that by reason of the fraud in the inception of the debt the judgment recovered was saved from the relief of the discharge in bankruptcy under statutory exception therefrom of certain classes of liabilities.* The Court said:

“Here the note was reduced to judgment before the bankruptcy and the action is on the judgment debt. But if the note was a liability for fraud in the sense that the loan for which it was given was obtained by fraud, no less is the judgment such a liability. The note became merged in the judgment, but the fact that the loan it represented was thus obtained applies to the judgment debt as much as the note. That the plaintiff should

suffer by having reduced the note to judgment before the bankruptcy would be to impose a vicarious penalty which Congress is not to be assumed to have intended in the absence of language clearly showing such a purpose."

It has been held that proof against the estate of the bankrupt of a claim reduced to judgment, although the judgment was obtained on a promissory note and not on the fraud which existed in the obtainment of the loan for which the note was given, does not preclude the judgment creditor from showing that the bankrupt was under liability to her for obtaining money from her by fraud. *Gehlen vs. Patterson*, (1928) 83 N.H. 328, 141 A 914, 17 Am. Bankr. NS 131.

The liability of an insurance agent for failure to return to the insurance Company premiums received by it on policies issued, and for cashing a check with the insurance company drawn on a bank in which he had no account, is excepted from the discharge in bankruptcy of such insurance agent by the provisions of Sec. 17 of the Bankruptcy Act (11 U.S.C.A. Sec. 35).

In the case of *Lyon vs. Lyon*, 115 Utah 466, 206 P. 2d 148 plaintiff brought suit against her former husband on a property settlement incorporated into a decree of divorce. Subsequent to the property settlement and the divorce, the defendant had taken Bankruptcy and scheduled the Judgment debt to the wife. The defendant contended that the obligation was discharged in Bankruptcy, and that the plaintiff could not recover. The Trial Court had permitted evidence of conversations prior to the making of the property settlement to

determine the nature of the settlement and, on such evidence held that the obligation was not dischargeable as it was excepted from discharge by Section 17 of the Bankruptcy Act as a "debt . . . for alimony due or to become due, or for maintenance or support of wife or child."

To the defendant's objection that the trial erred in permitting evidence outside the judgment record to be introduced and received in evidence to determine the nature of the obligation, the Utah Supreme Court held that Courts will look behind a judgment to ascertain whether the obligation which was merged in the judgment is dischargeable in bankruptcy, saying at page 472 of the Utah Reports:

"It may be true, as contended by defendant, that as a general rule a trial court will not look behind a judgment or decree to determine the nature thereof, unless it is so ambiguous or uncertain that extrinsic evidence is necessary to explain it. However, plaintiff has cited to us a number of cases holding that courts will look behind a judgment to ascertain whether the obligation which was merged in the judgment was dischargeable in bankruptcy . . . (citing cases). *The rule announced in the cases and texts above cited is reasonable and necessary to give full effect to the legislative intent. Otherwise, many obligations intended to be excepted from the discharge provisions of the Bankruptcy Act might nevertheless become discharged simply because they had been merged in judgments or into written contracts. The Court did not err in receiving*

extrinsic evidence to show the true nature of the obligation of defendant to plaintiff.” (emphasis supplied)

The defendant-appellants in their Brief, having admitted that there is much authority to the effect that the Court may receive evidence extrinsic of the judgment record to determine the true nature of the obligation and its dischargeability in bankruptcy, attempt to convince the court that the “weight of authority” and the “majority” of the decisions are to the contrary. Plaintiff has not counted the decisions and doubts that defendants or the authors they cite have counted them. Suffice it to say, that the Utah Courts, and the better reasoned decisions all hold that the trial court may look outside the judgment record to determine the nature of the obligation merged into the judgment and whether or not it is excepted from discharge.

Various other recent and well-considered cases, including a decision by the U.S. Court of Appeals (Cir. 2) have held that where the record does not disclose the nature of the underlying obligation, it may be proved alinude in determining the dischargeability of a judgment. *Greenfield vs. Tuccillo*, (1942), (Cir. 2), 129 Fed. 2d 854.

In the important recent opinion in *Fidelity & Casualty Company of New York vs. Golomosky*, (1946) 133 Conn. 317, 50 A. (2d) 817, 819, 820. Nate 60 Harv. L. Rev. 638 (1947), the Supreme Court of Errors of Connecticut unequivocally declared that the judgment-creditor should be permitted to prove, by evidence dehors the record of the action, that the note upon which the

judgment was based represented money misappropriated by the defendant, and that the debt was not within the defendant's discharge in bankruptcy. In so ruling the Court in effect, although not expressly, overruled its earlier decision in Consolidated Plan of Conn. Inc. vs. Bonitatibus 130 Conn. 199, 33 A 2d 140. With respect to its ruling in the Bonitatibus case the Court said:

“We held that the plaintiff could not, in support of its reply, go beyond the judgment and the record in the first action and offer evidence that the loan was obtained by false representations. Whether, in view of our present decision, we would adhere to that conclusion should such a situation again be presented, we have no need to consider.”

It is interesting to observe that the reasoning in this case flatly rejects the doctrine of waiver where the misrepresentation is asserted only to avoid the defense of a discharge in bankruptcy. The Court said:

“The decisions which have held that in determining the nature of the indebtedness a court cannot go behind the judgment record seem generally to have overlooked two principles which the cases place beyond dispute: *Where an action is brought upon a note, and a discharge in bankruptcy is set up as a defense, proof is admissible to show that the underlying debt was created by fraud or one of the other excepted causes.* American Surety Co. vs. McKiernan, 304 Mich. 322, 8 N.W. 2d 82, 145 ALR 1235, and note, 1238; Zimmerern vs. Blount, 238 F. 740, 745, 151 C.C. A.-5, 90; *and the rendition*

of a judgment upon an obligation does not change the Character of the indebtedness. Boynton vs. Ball, 121 U.S. 457, 466, 7 S. Ct. 981, 30 L. Ed. 985; Brown vs. Hannagan, Supra; Guernsey-Newton Co. vs. Napier, 151 Wash. 318. 320, 275 P. 724; Argall vs. Jadobs, 87 N.Y. 110, 113 41 Am. Rep. 357; Wade vs. Clark 52 Iowa 158, 159, 2 N.W. 1039 35 Am. Rep. 262; Young vs. Grau, supra. *In the light if these accepted principles, there would seem to be no escape from the conclusion that the reditution of a judgment based upon a note does not preclude proof by evidence extraneous to the record, in reply to a defense of discharge in bankruptcy, that the underlying debt was created by fraud, embezzlement, misappropriation or defalcation within the exception we are considering. Moreover, some of the decisions above cited falling within the first category seem to regard proof that the debt was created by one of these causes by means of evidence dehors the rendered as involving an attack upon that judgment; that clearly is not so, the plaintiff sues upon the judgment, the defendant pleads a defense entirely exteraneous to the action in which the judgment was rendered, i.e., his discharge and the plaintiff attacks his right to avail himself of that defense; the plaintiff is in no sense attacking the judgment but is throughout insisting upon his right to recover upon it in the manner and form in which it was rendered."* (emphasis supplied)

In Ghelen vs. Patterson, (1928) 83 N. H. 329, 141 A.

914, 915, 916, 917, the plaintiff had brought suit on the note and obtained judgment prior to the debtor's discharge in bankruptcy. The bankrupt contended that the judgment-debt was released by the discharge even though the loan for which the note was given was obtained by fraud. The Supreme Court of New Hampshire held that by virtue of the fraud the judgment in contract was not discharged, saying in part:

"It follows that neither the action on the note nor the present action on the judgment debt barred an action for the fraud, any more than the proof of claim against the defendant's bankrupt estate. And the fraud may be pleaded to save the judgment from its release by the discharge in bankruptcy.

"It follows that liabilities for fraudulently obtaining property, as intended by the amendment, mean claims arising out of such conduct. Whatever maybe the form of action sued on, if it appears that the cause of action arose from such fraud as the section specifies, the liability set forth in the action is undischarged. *Lund vs. Bull*, supra; *Raymond vs. Cohen*, 80 N.Y. 586, 112 A. 909. Claims created by the fraud of one acting in an official or fiduciary capacity are not discharged whether or not they are 'provable debts' at the date of bankruptcy (*Brown vs. Hannagan*, supra), and it must be equally true that the discharge of liabilities for fraudently obtaining property otherwise does not depend upon the status of such debts. The test is not of ability to show that at the date of bankruptcy there was a prov-

able claim of fraud, but is of ability to show that there was then a provable liability of some kind which sprang from the bankrupt's fraud. *Zimmern vs. Blount*, (C.C.A.) 238 Fed. 740; *Gregory vs. Williams*, 106 Kan. 819, 189 P. 932.

"The note became merged in the judgment, but the fact that the loan it represented was thus obtained applies to the judgment debt as much as to the note. That the plaintiff should suffer by having reduced the note to judgment before the bankruptcy would be to impose a vicarious penalty which Congress is not to be assumed to have intended, in the absence of language clearly showing such a purpose."

The decision in *Gehlen vs. Patterson*, *supra*, is also noteworthy because of its complete repudiation of the theory that the fraud had been waived. The Court declared:

"Nor was there an election of remedies in suing on the note rather than for the fraud. The plaintiff had two causes of action which were separate and independent and she had more than a choice between them. Suit on one was not inconsistent with suit on the other. Suit for the fraud would not destroy liability on the note but on the contrary would affirm it. Conversely, suit on the note did not affect or necessarily raise the issue of fraud. While payment of one claim might liquidate in full or in part the damages for the other, yet until such payment both claims may be sued on at the same time and, under what seems the better procedure, judgments be

obtained in both. The judgments would not mutually conflict, although satisfaction of one would operate to satisfy in full or in part the other. 'Where the remedies afforded are inconsistent, it is the election of one that bars the other; where they are consistent, it is the satisfaction which operates as a bar.' *Frederickson vs. Nye*, 110 Oh. St. 459, 144 N.E. 299, 35 A.L.R. 1163. Parallel situations are found in the frequent instances of separate suits at the same time on a note and in foreclosure of its security and in separate actions against joint wrongdoers."

As stated by the Utah Supreme Court in the case of *National Finance Company of Utah vs. Valdez* 11 Utah 2d 339, 359 P. 2d 9, discussed above, "... a discharge in bankruptcy is neither a payment nor the extinguishment of debts. It is simply a bar to their enforcement by legal proceedings," and, "a loan evidenced by a promissory note which is obtained by fraud is excepted from a discharge in bankruptcy."

The respondent contends that a loan evidenced by a promissory note obtained by fraud being excepted from a discharge in bankruptcy, so also is a judgment upon such promissory note evidencing a loan obtained by fraud.

As it so often happens, and, has happened in the case before this Court, a lender may not be aware of the fraud in the inception of the loan contract at the time he finds it necessary to institute action on the note. The fraud isn't discovered until disclosed through or as a result of the bankruptcy proceedings when the

bankrupt lists his obligations and the dates when incurred as required by the General Orders and Forms for bankruptcy. Under such circumstances, the Courts are particularly hesitant in applying the doctrines of waiver and election of remedies, for indeed—how can there be a waiver or an election when the existence of the second cause of action is unknown. The case of *Chester-Neal Co. vs. Generazzo*, (1942) 20 N.J. Misc. 296, 26 A. 2d 876, was submitted to the Court on stipulated facts whereby it was agreed that the defendant, in obtaining a loan from the plaintiff, represented, in writing, that he had no outstanding indebtedness. The financial statement was false when made, to defendant's knowledge, in that he owed debts to a series of other finance and merchandising companies. When the defendant defaulted, plaintiff, still ignorant of the falsity of the representations, sued defendant on the note and recovered judgment. Thereafter, the defendant filed a petition in bankruptcy and the plaintiff discovered the false representation. The Court held that the plaintiff was not subject to the defense of election of remedies in bringing the second suit based on a cause of action in fraud.

In *Personal Finance Company of New Haven vs. McMahon* (1943) Davlin, Jr., Ct. of Com. Pleas, New Haven Co., Conn., the Court, by Memorandum of Demurrer stated:

“The former action in this case was on the note. The essentials for bringing of the fraud action did not come into existence until after the defendant had filed his petition in bankruptcy and therein disclosed the fraud. Where the fraud is not discovered until after entry of judgment on

the contract an action for damages for fraud will lie. *Local Loan Co., Inc. vs. Guinessey*, 33 N.Y.S. 2d 62. The test is not whether the causes of action arise out of the same general subject matter, but whether one action produces a status which necessarily bars the other. Two causes of action existed in this case, one on the note and the other for fraud. The original action dealt only with the former. No claim was made in the latter because the existence of facts to support it were not known."

The argument of appellant that in cases holding that the court may look outside the record there has only been one step in the proceedings, whereas in the case now before the Court there has been two (suit on note plus suit on judgment based on note), is without merit. The test is whether the debt is one incurred through "false pretenses or misrepresentations" not how far the creditor has gone before it is discovered or how far creditor has proceeded before the debtor takes out bankruptcy.

To the appellant's argument that to permit extrinsic evidence to be introduced to determine the nature of the debt merged in the judgment would cause the bankrupt "unreasonable harassment," suffice it to say, that it is the intention of the Bankruptcy Act that debts incurred through "false pretenses or misrepresentations" should not be discharged or bared. If a person has cheated or defrauded another, he should not complain that he is subjected to litigation as a result thereof, and if that be "unreasonable harassment," then it is intended by the bankruptcy act that such persons be so harassed.

That the statement contained in 8 C.J.S Bankruptcy Sec. 587, cited by appellant accurately states a view that has been adopted by some courts, however, such view point as set forth in C.J.S. is supported only by the citation of two cases and is contrary to the better reasoned opinions and the prior decisions of the Utah Supreme Court.

CONCLUSION

The defendants prior to this action never having asserted their discharge in bankruptcy, the plaintiff is not bared from showing that the obligation merged into plaintiff's judgment was incurred through the fraud or misrepresentations of the defendants, and is, thus, excepted from discharge in bankruptcy. The trial court in this action on such judgment may look beyond the record of the Ogden City Court action to ascertain whether or not the obligation which was merged in the Judgment entered by the Ogden City Court is excepted from discharge in bankruptcy, and, the defendants Motion for Judgment on the Pleadings was, therefore, properly denied by the District Court.

Respectfully submitted,

E. MORGAN WIXOM

1010 First Security Bank Building
Ogden, Utah

*Attorney for Plaintiff
and Respondent*