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Grant M. Robertson And Edith Williams Robertson, Aka Edith L. Robertson v. Donald W. Geis; Sloan Smith; Sloan Smith Associates, Ltd.; First Dividend Corporation, A Utah Corporation; And Intermountain Capital Corporation of Utah And Intermountain Capital Corporation of Utah v. John W. Robertson And Zelda Robertson : Brief of Respondents Grant M. Robertson And Edith Williams Robertson Aka Edith L. Robertson, His Wife Plaintiffs-Respondents John W. Robertson And Zelda Robertson, His Wife Third-Party Defendants And Respondents

IN THE SUPREME COURT OF THE STATE OF UTAH

GRANT M. ROBERTSON and EDITH WILLIAMS ROBERTSON, aka EDITH L. ROBERTSON, his wife,
Plaintiffs and Respondents,
vs.
DONALD W. GEIS; SLOAN SMITH; SLOAN SMITH ASSOCIATES LTD.; FIRST DIVIDEND CORPORATION, a Utah corporation, and INTERMOUNTAIN CAPITAL CORPORATION OF UTAH,
Defendants and Appellants,
and
INTERMOUNTAIN CAPITAL CORPORATION OF UTAH, a Utah corporation,
Defendant and Third-Party Plaintiff and Appellant,
vs.
JOHN W. ROBERTSON and ZELDA ROBERTSON, his wife,
Third-Party Defendants and Respondents.

Case No. 10072

BRIEF OF RESPONDENTS

GRANT M. ROBERTSON AND EDITH [illegible] ROBERTSON aka EDITH L. ROBERTSON [illegible]

PLAINTIFFS-RESPONDENTS

JOHN W. ROBERTSON AND ZELDA [illegible] WIFE THIRD-PARTY DEFENDANTS AND [illegible]

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Plaintiffs and Respondents,
vs.
DONALD W. GEIS; SLOAN SMITH; SLOAN SMITH ASSOCIATES LTD.; FIRST DIVIDEND CORPORATION, a Utah corporation, and INTERMOUNTAIN CAPITAL CORPORATION OF UTAH,
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and
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Defendant and Third-Party Plaintiff and Appellant,
vs.
JOHN W. ROBERTSON and ZELDA ROBERTSON, his wife,
Third-Party Defendants and Repondents.

Cae No. 12902

BRIEF OF RESPONDENTS

GRANT M. ROBERTSON AND EDITH WILLIAMS ROBERTSON aka EDITH L. ROBERTSON, HIS WIFE

PLAINTIFFS-RESPONDENTS

JOHN W. ROBERTSON AND ZELDA ROBERTSON, HIS WIFE THIRD-PARTY DEFENDANTS AND RESPONDENTS

NATURE OF THE CASE

This was an action by the plaintiffs against the defendants Donald W. Geis and Sloan Smith for damages for fraud and as against the defendant Intermountain Capital Company to void and set aside a mortgage said company had as against certain real property owned by the plaintiffs and third-party defendants.

DISPOSITION IN THE LOWER COURT

The Third Judicial District Court in and for Salt Lake County, the Honorable Bryant H. Croft presiding, granted the plaintiffs judgment for damages for fraud as against defendants Donald W. Geis and Sloan Smith and a judgment in plaintiffs' favor and also in third-party defendants' favor voiding and setting aside the mortgage on their real property that had been held by defendant Intermountain Capital Corporation of Utah.

RELIEF SOUGHT ON APPEAL

Plaintiffs Grant M. Robertson and Edith Robertson, his wife, and third-party defendants John W. Robertson and Zelda Robertson, his wife, seek an affirmance on this appeal of that judgment entered by the trial court on March 31, 1972 (R. 240 through 242).

STATEMENT OF FACTS

The brief of defendant Intermountain Capital Corporation heretofore filed only recites part of the facts applicable to the appeal and those which relate to its controversy with the plaintiffs and third-party defendants. Inasmuch as other defendants, Donald W. Geis and Sloan Smith, have also appealed and because their involvement is closely related factually to that of Intermountain Capital's, the pertinent facts will be restated in this brief. The parties will either be referred to by name (sometimes not their entire name as e.g. Intermountain) or by their party designation in the trial court.

This case is quite complicated factually and its trial to the Honorable Bryant H. Croft, sitting without a jury, lasted the better part of three days and covered some 500 pages of trial transcript. It commenced on October 28, 1971 (R. 286). Following the trial itself, most of the parties submitted detailed memorandum relating to the facts and legal issues involved and several post-trial hearings on motions were heard. After these involved proceedings and on March 31, 1972, Judge Croft signed the Findings of Fact, Conclusions of Law and Judgment. (R. 226 through 242). Since the trial court found in favor of the plaintiffs and third-party defendants and against the defendants Geis, Smith and Intermountain, the facts recited herein will be stated favorably to the position of the prevailing parties and will be similar to those recited in the formal Findings of Facts since all such findings were amply supported by the evidence in the record.

Mr. Grant M. Robertson and his wife, Edith, are an elderly couple who have lived for many years at 1548 Logan Avenue, Salt Lake City, Utah (R. 289). In 1949 they acquired some eight and one-half acres of unimproved real property situated generally at 7690 South 10th East in Salt Lake County (R. 290). Most of this property forms the subject matter of this lawsuit. In 1954, Mr. and Mrs. Grant M. Robertson conveyed by warranty deed a four by seven rod parcel from this larger tract to their son and daughter-in-law, the third party defendants, John W. Robertson and Zelda Robertson (R. 292). Prior to 1954 a dwelling and garage had been constructed partially on this four by seven rod parcel and it was then and is now the dwelling of the son and daughter-in-law and their

family (R. 290 through 292). For various reasons, this garage and dwelling were constructed so they straddled the property line and were one-half on the property deeded to them and one-half on the property retained by Mr. and Mrs. Grant M. Robertson and which was later mortgaged to Intermountain Capital (R. 292). Because of the latter fact, Intermountain Capital joined the son and daughter-in-law as parties to this lawsuit and as part of their attempt to foreclose the mortgage on this property. Had the trial court not voided the mortgage and had it instead allowed Intermountain Capital to foreclose, one of the results would have been to have the son and daughter-in-law ending up without title to approximately one-half of the property on which their family home is situated (R. 292). This fact also has significance in that the 1963 warranty deed from Mr. and Mrs. Grant M. Robertson to Donald W. Geis, which eventually resulted in the mortgage to Intermountain Capital, made no exclusion or exception for the earlier recorded conveyance to the son and daughter-in-law (Ex. 1-P). Prior to granting the mortgage, Intermountain Capital's president and chief executive officer, John M. Whiteley, who was himself an experienced real estate broker (R. 640), personally inspected the eight and one-half acre parcel, in the company of Sloan Smith, and noted that this dwelling had been built thereon (R. 664). Before Intermountain made its loan, Mr. Whiteley or his attorneys had been furnished with a copy of the deed (Ex. 1-P). No inquiry was ever made by Mr. Whiteley as to what this dwelling was doing on this property prior to the $60,000.00 mortgage loan by his company (R. 665). By Mr. Whiteley's own admission, he saw this dwelling on the property and either knew or should

have known that the deed upon which his company's mortgage was based (Ex. 1-P) made no exclusion, and yet that no improvements thereon had been conveyed or were being mortgaged. This alone should have caused him to make inquiry. Had such been made, Whiteley would definitely have discovered the Robertsons' interest in the property, their transactions with Donald W. Geis and Sloan Smith and he would thereby have fully apprised himself and Intermountain of the fraudulent nature of what was transpiring and which had induced the Robertsons to deed the property in the first place. Of course, these facts were unnecessary to the trial court's decision since it found Whiteley and Intermountain actually knew before its mortgage and $60,000.00 loan of most of the arrangements between the Robertsons and Geis and Smith since the latter had told Whiteley of these arrangements (R. 232, 233). However, the facts recited above may alone have prevented Intermountain from being a bona fide mortgagee for value and without notice and even without this other evidence concerning Whiteley and Intermountain's extensive knowledge as to arrangements between the Robertsons and Geis and Smith.

Donald W. Geis was a neighbor of Mr. and Mrs. Grant M. Robertson and the Robertsons and Mr. Geis and his wife had become very close and, on many occasions, the Robertsons had looked after the young children of the Geis'. During this time and during the events in question involving the Robertsons (R. 297, 298) which transpired mainly in 1963, Mr. Geis was the agent of Sloan Smith (R. 443). At this same time Mr. Smith was promoting, among many other ventures, a scheme involving

the sale or financing of used equipment in Central America. In essence, this scheme involved an attempt by Geis and Smith and the latter's corporations, to obtain from investors, most of whom were in Salt Lake County, cash or unencumbered property (which could then be used as collateral and cash obtained for it), with the cash then to be used by Smith and his corporations to obtain in the United States various used equipment which was then to be transported to Central America to be financed or sold there, allegedly at a tremendous profit (R. 302 through 307). From these profits that were supposed to be obtained, it was represented that the investors, including the Robertsons, were to obtain a substantial return (R. 309).

Based on these representations about the Central American venture as well as a number of other representations that will be referred to hereafter, Mr. and Mrs. Grant M. Robertson conveyed to Donald W. Geis by warranty deed dated May 2, 1963, the eight and one-half acres of property involved in this case (Ex. 1-P). Shortly thereafter, but as part of the same transaction, Mr. and Mrs. Robertson signed and delivered to Geis for Sloan Smith, a document entitled "Memorandum Trust Agreement" (Ex. 2-P).

Thereafter, a number of transactions occurred with respect to this property and related matters which were not disclosed to Mr. and Mrs. Robertson by anyone until a number of months later. Some time prior to August 17, 1963, Mr. Geis deeded this eight and one-half acres to a newly formed Utah corporation named First Dividend Corporation (R. 630). This corporation had been formed

during that summer at the instance of Sloan Smith and John M. Whiteley, the president of Intermountain Capital (R. 471). On August 17, 1963, Intermountain Capital loaned to First Dividend Corporation the sum of $60,000.00 and took as security for its repayment, a mortgage on the eight and one-half acres, in addition to other collateral (Ex. 24-P). By deed dated August 5, 1964, First Dividend deeded back to Mr. and Mrs. Robertson the eight and one-half acres subject to the mortgage to Intermountain Capital (Ex. 3-P). This was the first that the Robertsons knew about the involvement of Intermountain Capital although it was not until some time after that when they learned any substantial details about what had occurred (R. 349 through 354).

The agreement between Geis for Smith and the Robertsons contemplated, among other terms, that the eight and one-half acres would be used to obtain money for the Central American venture and that in return, the Robertsons would receive periodic payments and that eventually, and in a period not to exceed ten years, that the property would cease to be used as collateral and would be returned to the Robertsons free and clear (Ex. 2-P). When none of these periodic payments were forthcoming to the Robertsons, they began investigating the circumstances and, after being largely thwarted in finding out anything for themselves from the other parties involved, hired legal counsel and on October 25, 1968 this lawsuit was commenced (R. 1 through 6).

As noted above, this fact situation is quite a complicated one, and it is not deemed necessary to burden this brief with all or even most of the details as to what oc-

curred between Geis and Smith on one side and Mr. and Mrs. Robertson on the other side. The trial court did find by clear and convincing evidence that as a result of these transactions, Geis and Smith committed all of the elements necessary to constitute actionable fraud as against the Robertsons and that as the result thereof the Robertsons deeded their property to Geis (R. 229 through 232). As the factual basis for its finding of fraud, the trial court found that Geis for Smith made a number of misrepresentations to the Robertsons, all of which were false either wholly or in material part, that these representations were material and were made to induce the Robertsons to part with the eight and one-half acres and that the Robertsons justifiably relied thereon in deeding the property to Geis. In substance, these misrepresentations were as follows with a brief summary of wherein they were false following in parenthesis.

A. That the property would be used by Geis and Smith as collateral to borrow money to invest in a business of buying used equipment and then reselling the same in Central America and that the proceeds obtained from a loan secured by the property would not be used for any other purpose whatsoever (R. 311). (In fact, most of the proceeds from the $60,000.00 loan were not used for that purpose (Ex. 22-P) and the evidence was such that the trial court was justified in concluding that Geis and Smith never intended to exclusively use the money for that purpose.)

B. That the eight and one-half acres would be conveyed to Geis for a maximum of ten years and on or before the expiration of ten years from the time of the con-

veyance, the property would be conveyed back to the plaintiffs free and clear of all encumbrances (R. 628). (In fact, Geis and Smith knew when this representation was made that the property would be later used as collateral on an unlimited basis. That is, they were then contemplating mortgaging it to Intermountain or some other lender and there was nothing in the loan agreement with Intermountain insisting that the property not be used as collateral beyond the ten years Ex. 24-P).

C. Geis and Smith agreed to pay to the Robertsons for the use of their property for this period not to exceed ten years, a minimum of $2,500.00 per year, less the property taxes (R. 309, 314). (In fact, Geis and Smith never paid the Robertsons one dime except $300.00 on their property taxes. While this representation may sound more promissory than fraudulent, the evidence of what Smith was, in fact, making and of what he was doing with the money invested, justified the trial court in believing that this wasn't just a grandiose promise made that couldn't later be kept, but was rather a false statement when made since Smith then knew he would never keep it.)

D. That no mortgage or lien would be placed against the property encumbering it for more than $25,000.00 (R. 314, 315). (In fact, Geis and Smith knew at the time that they were going to use the property as collateral for a loan of $60,000.00, or more, and within four months of obtaining it a loan for $60,000.00 was obtained with this property as part of the security (Ex. 24-P)

E. That at any time during the ten years, the plaintiffs could request that one or more lots of the eight and one-half acres could be withdrawn from whatever security

arrangement encumbered it and that no security arrangement would be entered into affecting the property where these withdrawals could not be made (R. 315). (In fact, Geis and Smith, and considering their sophistication, had to have known no lender would take the property as collateral on this kind of a release arrangement. Moreover, when the loan from Intermountain was entered into there was no attempt to provide for such a release arrangement.)

F. That the plaintiffs were "absolutely safe" in entering into this arrangement with their property (R. 626, 627). (Considering their circumstances at the time, (i.e. in part the lack of success until then and the tremendous amounts they were obligating themselves to repay) Geis and Smith could not possibly have honestly believed the Robertsons' investment was "absolutely safe.")

G. That Geis and Smith were already extremely successful in the used equipment business in Central America and already had made and were making large profits from this business (R. 628). (In fact, the evidence indicated Geis and Smith had no success up to that time in this venture.)

H. That in addition to the large profits being made in the Central American used equipment business, that Smith had been successful in other ventures and that he was a wealthy man and that his resources would insure performance to the plaintiffs on their agreement (R. 304). (In fact, the evidence showed that Smith had no real financial substance of his own and his only substance was his glib tongue and borrowed assets.)

I. That other persons had made similar investments and had already been paid large profits by Geis and Smith and that the plaintiffs would succeed as these other investors had (R. 304 through 307, 626 through 628). (In fact, no one made anything investing with Geis and Smith. To the contrary, their experiences were similar to that of the Robertsons.)

J. Plaintiffs were not told that a corporation would be formed and that the property would be conveyed to this corporation in return for stock which went to Smith nor were they told that this corporation would then obtain the loan and use the property as collateral for it (R. 638). (In fact, the Robertsons were told the loan would be made through a bank in Central America or, as their agent, through a New York bank (R. 316).

The trial court made no finding that Intermountain Capital was itself guilty of fraud as against the Robertsons. Rather, it found, in substance, that there was an unusually close association between Intermountain Capital, through its president John M. Whiteley, and Geis and particularly Sloan Smith. The trial court further found that prior to parting with its $60,000.00 to First Dividend and taking the mortgage on the Robertsons' property, that Mr. Whiteley and Intermountain Capital were aware of a number of facts and circumstances that precluded Intermountain Capital from claiming it was a bona fide mortgagee for value and without notice, and as to this eight and one-half acres. Based on these same facts, the trial court concluded that Geis and Smith obtained the Robertson's property to hold in trust and that since Whiteley and Intermountain knew of the material portions of

this trust arrangement, Intermountain's mortgage was subject to the trust (R. 236). Among these facts and circumstances showing the relationship of these parties and supporting the trial court's findings and conclusions, are the following:

A. Well in advance of the August 17, 1963, $60,000.00 loan of Intermountain to First Dividend, John M. Whiteley had not only gone to the Robertson property with Sloan Smith to look at it, but he had actually been given a copy of the Memorandum Trust Agreement (Ex. 2-P) and had been advised by Smith that this was the basis upon which the property had been obtained from the Robertsons (R. 479, 480, 488). Smith testified to the foregoing at the trial although Whiteley denied having seen Exhibit 2-P. On this disputed evidence, the trial court believed Smith and found that Whiteley had seen this document prior to the date of the loan and that therefore he and, of course, Intermountain Capital, knew about its contents prior to parting with the $60,000.00. Among its other terms, Exhibit 2-P provides that the property could not be used as collateral beyond ten years, and that at the conclusion of that time, Mrs. Robertson had the option of having the property deeded back to her free and clear of encumbrances.

B. In addition to finding that Mr. Whiteley had actually seen Exhibit 2-P, the trial court found that Smith had told Whiteley all of the following before the loan was made: That Smith and his companies needed money to finance the used equipment business in Central America (R. 403); that Smith and Geis were obtaining property of one kind or another from various investors and they in-

tended to use these properties to obtain financing for the business in Central America (R. 469, 670; that Geis was a neighbor to the plaintiffs and had a close personal relationship with them and that they owned the unimproved eight and one-half acres free and clear (R. 479); that based on Geis' discussion with plaintiffs, the plaintiffs had conveyed this eight and one-half acres to Geis to be used for security purposes to raise money but that Geis had told the plaintiffs that the property would not be used for that purpose for more than ten years and that within that time the property would be reconveyed to the plaintiffs free and clear (R. 480); that the property was worth at least $25,000.00 and that nothing had been paid to the plaintiffs for the property except the plaintiffs were to receive annual payments during the time the property was being used (R. 479).

C. Prior to August 17, 1963, Mr. Whiteley was shown the deed of the Robertsons to Geis (Ex. 1-P), and he would therefore have been aware that no exclusion was contained on that deed (R. 487, 488). Also, prior to the time of the loan, Mr. Whiteley inspected the property and saw the dwelling thereon and later and before August 17, 1963 learned that a four by seven rod parcel had been earlier conveyed (R. 665). Nevertheless, Mr. Whiteley and Intermountain Capital made no inquiry nor did they attempt to contact the residents of the dwelling or the Robertsons concerning the transaction (R. 665).

D. Commencing in 1961 and from time to time continuing up to August 17, 1963, Smith and Whiteley were involved in various business deals together including the one in question (R. 460, 461). In fact, in 1961 or 1962

Whiteley personally had invested $500.00 with Sloan Smith in another venture (R. 388). They also saw each other a good deal socially during this same period of time and continuing after that date they were associates socially and in business matters (R. 399).

E. First Dividend Corporation was incorporated at the insistance of Whiteley and Intermountain and in order to enable Intermountain Capital to make the loan to a domestic corporation (R. 471). This was so because Intermountain Capital was a so-called "SBIC or Small Investment Business Corporation", utilizing some capital obtained from the federal government, and it was essential that the $60,000.00 loan be made to a domestic corporation.

F. Intermountain Capital stood to gain if the $60,000.00 loan to First Dividend was successful in that the loan agreement granted Intermountain a warrant or option to purchase at a favorable price up to 20% of First Dividend's authorized stock (R. 653). This was, of course, in addition to the 10% interest charged First Dividend by Intermountain on the loan and which was a very good rate at that time (R. 673).

G. John M. Whiteley's brother, Winslow B. Whiteley, was a large investor in Intermountain Capital and also had an interest in Whiteley Properties, another corporation that had a substantial interest in Intermountain Capital during this period of time. In effect, and through personal holdings and his interest in Whiteley Properties, Winslow B. Whiteley's interest in Intermountain was approximately 20% of its outstanding stock (R. 641, 642).

Winslow B. Whiteley was a director of First Dividend from its inception through the period of time that Intermountain on August 17, 1963 made the $60,000.00 loan to it and at that same time he was a director of Intermountain (R. 643, 675). The name of Winslow B. Whiteley had been used prominently by Geis in his convincing the plaintiffs to transfer their property and in that the plaintiffs had been told that he was a rich potato farmer who had invested $125,000.00 in the same venture (R. 305).

H. Sloan Smith had a financial interest in Intermountain Capital prior to the time the loan was made and at the time it was made on August 17, 1963. He had been listed as a subscriber for $25,000.00 of its stock but hadn't come up with the money although he had, in effect, invested $10,000.00 in that company.

I. It was evident from the testimony at the trial that John M. Whiteley had only the most superficial knowledge of the true facts relating to Geis, Smith and the latter's companies prior to making the loan and that he knew nothing verified or concrete to indicate that Smith was a man of financial substance (R. 654 through 659). About all he knew about Smith's financial situation prior to the loan being made were that Smith had several new cars, that he was flying around in a two-engine airplane and that he had a large home. Any kind of reasonable investigation by Whiteley and Intermountain would have disclosed that Smith could not have obtained the eight and one-half acres free and clear without some underlying agreement that sharply restricted its alienability.

J. During July, 1963, Whiteley told Smith that Intermountain would loan First Dividend the $60,000.00 and provided that there was adequate security and that his board was satisfied with the security (R. 487). On one or more occasions prior to the loan being made, Whiteley prepared in his own hand a trial balance showing First Dividends asset including the plaintiffs' property which showed an asset value to First Dividend of $24,000.00 and Whiteley went back to his board and advised them that these assets were to be the security for the loan (R. 659). Also prior to the loan being made by Intermountain, Whiteley knew that nothing had been paid to the plaintiffs for the conveyance of this property and that any consideration they would receive would have to come to them in the manner set forth in Exhibit 2-P (R. 479, 480). In other words, Whiteley and Intermountain Capital knew prior to the loan being made that the real party in interest to the property was the plaintiffs and that, in fact, Smith and First Dividend Corporation, in their own right, had no real interest in the property.

K. Virtually no collection efforts were made by Intermountain Capital against either First Dividend, Smith or the plaintiffs and after the loan became quickly in default. The foreclosure proceedings itself was not commenced until some five or six months after this lawsuit was filed in October of 1968 (R. 44 through 72). From November of 1964 until the foreclosure proceedings were commenced in May of 1969, no cash payments were made by anyone on this loan although Sloan Smith did make a $2,500.00 payment by check in January, 1965, but the check "bounced" (Ex. 18-P). Intermountain Capital's ap-

parent lack of desire to collect or foreclose in connection with this property is some indication of Intermountain's guilty involvement with Geis and Smith. By contrast, consider what a true bona fide mortgagee would have done in the event of the kind of default that existed here.

ARGUMENT

POINT I

INTERMOUNTAIN CAPITAL TOOK THE MORTGAGE ON THE ROBERTSON PROPERTY SUBJECT TO THE TERMS OF THE AGREEMENT BETWEEN THE ROBERTSONS AND GEIS AND SMITH AND CANNOT QUALIFY AS A BONA FIDE MORTGAGEE FOR VALUE AND WITHOUT NOTICE.

Under Point I of its brief, Intermountain Capital argues that the Robertsons knowingly conveyed the property and agreed in writing to the placing of an encumbrance thereon and that therefore they cannot avoid the rights of Intermountain who thereafter advanced monies and received back a mortgage in accordance with the terms of that agreement. To some extent, the foregoing is correct. That is, the plaintiffs did convey their property knowing an encumbrance would be placed thereon, although the manner in which this was done was different than they had been told. However, in conveying the property to Geis, the plaintiffs did so subject to the Memorandum Trust Agreement (Ex. 2-P) and also, as far as Geis and Smith were concerned, subject to a number of other oral conditions. On somewhat disputed evidence the trial

court chose to believe that Intermountain, through its president Whiteley, not only saw this agreement prior to making its loan, but that Whiteley was advised of most of these other oral conditions by Smith. In other words, the trial court found that at the time Intermountain Capital parted with its money, it knew, among other terms as between Smith and Geis and the Robertsons that the property had to be conveyed back to the Robertsons free and clear no later than within ten years, (i.e. by May 1, 1973) and that it couldn't be used to secure a larger loan than $25,000.00. Clearly, where Intermountain Capital had actual knowledge of these terms, as the court found, it could not take a mortgage on the property and ignore those terms as it has sought to do in this litigation.

It is true that the Robertsons never recorded Exhibit 2-P nor any other document evidencing their agreement with Geis and Smith. However, the purpose of recording a document in a real property transaction is to attempt to give later purchasers or mortgagees actual notice and in the event a subsequent purchaser or mortgagee doesn't actually learn of the recorded document, he is legally deemed to have knowledge of it based on a theory of "constructive notice". In this case recording would have done nothing more than occurred, since the court found Whiteley and therefore Intermountain Capital actually knew of these terms and the evidence amply supports that finding.

Webster, et al v. Knop, et al., 6 U.2d 273, 312 P.2d 557 (Utah 1957) involved a somewhat similar situation. In the *Webster* case, one of the defendants Knop and the

two plaintiffs, Lloyd and Carl Webster, had entered into a written grubstake agreement whereby, subject to various terms, the three of them agreed to share one-third each in any claims staked pursuant to their contract. Thereafter, the claims in question were staked in the names of Knop and the two Websters, but by reason of the applicable law at that time, the location of these claims was invalid and vested nothing in the three locators. Subsequently, and under circumstances where the law had changed and the location was valid, Knop relocated the claims in his own name. Still later, Knop attempted to transfer the entire interest in these claims, and free of any interest in the Websters, to two other persons, Davis and Shumway.

The evidence further indicated in the Webster case that Davis and Shumway had, before purchasing these claims from Knop, obtained a title search and the opinion of two attorneys to the effect that the original location was invalid, the relocation was valid and that therefore the sole interest was in Knop. The plaintiffs Webster commenced the suit to quiet title as against Knop, Davis and Shumway and others to their two-thirds interest in these claims and they contended that Davis and Shumway could not be bona fide purchasers for value and without notice by reason of the knowledge they had or should have had prior to the transfer from Knop.

In this regard, and at page 558 of 312 P.2d, the court stated as follows:

> Prior to the purchase of the claims in question by the defendants Davis and Shumway, both had notice of the invalid first location, having found

> the records of notice of location and amended notice in the County Recorder's Office. These were filed under the names of Knop, and the two plaintiffs Webster. The defendants Davis and Shumway also had actual notice of the grubstake agreement under the terms of which the original location was made. Nevertheless though having been apprised of a possibility of a claim of interest in the mining claims they did not seek out the plaintiffs in this action to inquire if they claimed an interest. Rather, they relied on two title opinions by two attorneys to the effect that since the original location was invalid and since the grubstake agreement had lapsed before the relocation, such relocation in the name of John J. Knop was valid and exclusive.

The Supreme Court rejected the argument that under these circumstances and with this prior notice and knowledge, Davis and Shumway could be bona fide purchasers for value from Knop. In affirming the trial court's finding quieting title to two-thirds interest in the two Websters the Supreme Court stated as follows:

> The second question is: Were the subsequent transferees having notice of the grubstake agreement and the original location in the names of the three parties to the agreement bona fide purchasers for value from the one who relocated so as to terminate the equitable constructive trust interest in the beneficiaries?
>
> The equitable interest of a trust in the beneficiaries may be cut off as against a bona fide purchaser for value from the trustee or constructive trustee. He must have had no notice, actual or constructive, and he must pay value. Peterson v. Peterson, 112 Utah 554, 190 P.2d 135. As stated in

the Restatement, Restitution, § 12(a), adopted in the Peterson case:

> 'A person has notice of facts giving rise to a constructive trust not only when he knows them, but also when he should know them; that is when he knows facts which would lead a reasonably intelligent and diligent person to inquire whether there are circumstances which would give rise to a constructive trust, and if such inquiry when pursued with reasonable intelligence and diligence would give him knowledge or reason to know of such circumstances.'

When the defendants Davis and Shumway entered into agreements for the purchase of the Faith Claims, they knew of the prior location and the parties named as colocators. This alone should have put them on notice that an inquiry should be made of the original colocators. Even though value was paid, reliance cannot in such a case be made entirely on title opinions. A title opinion cannot be sufficient to satisfy a duty to inquire as to possible equitable interest any more than it can without inquiry as to rights of parties in possession. When this fact is added to the fact that they knew of the existence of a prior grubstake agreement, a duty of diligent inquiry arose. Failure in this duty is failure of an element of good faith.

In the instant case we are definitely not dealing with a lender such as a bank or savings and loan association and where that lender has parted with its money having no notice or knowledge of some secret arrangement between its mortgagor and an earlier transferor. If that were the case and where the lender is unaware of such arrangements, the courts have held and should hold in favor of

the innocent mortgagee. This is not the situation in the instant case, and it is clear from the evidence and considering the relationship between John M. Whiteley and Sloan Smith that, in effect, Intermountain Capital and First Dividend became something like partners in this Central American venture. More important, Intermountain Capital through its president had actual knowledge of the arrangements relating to the property between the Robertson on one hand and Geis and Smith on the other hand and it would be unconscionable and contrary to law to say that under those circumstances they could cut off the Robertsons from the benefit of those agreements.

It is to be noted that in the *Webster v. Knop* case, the Supreme Court indicates that the transferee would not qualify as a bona fide purchaser for value where he should have known of the facts, but didn't actually know of them. In the instant case the record is replete with facts and circumstances showing that Intermountain Capital should have known all about the transaction and that it acted with recklessness in making this loan and taking this mortgage under the circumstances under which it did even without actual knowledge. However, we do not need to rely upon what should have been known by Intermountain Capital since the court expressly found that it actually knew the key terms as between Geis and Smith and the Robertsons and particularly the crucial one that the property had to be returned within ten years.

Another Utah Supreme Court case somewhat in point is *Schow, et ux. v. Guardtone, Inc., et al.,* 18 U.2d 135, 417 P.2d 643 (Utah 1966). In the *Schow* case the plaintiffs

Schow, who were homeowners, had contracted with Guardtone, Inc. for the purchase of an intercommunication and fire alarm system. Thereafter, the contract was assigned to Prudential Federal Savings, who was also one of the defendants in the lawsuit brought by the Schows to invalidate the contract and to avoid the assignment.

The jury had found that Guardtone had defrauded the plaintiffs but the trial court had set that finding aside. The Supreme Court reversed and reinstated the jury's verdict, and on the subject of Prudential's rights as the assignee of the contract, the Supreme Court stated as follows:

> We turn to a consideration of the rights of the assignee, the defendant Prudential Federal Savings. It is pertinent to observe that the fraud having been established to avoid the contract with Guardtone, the burden of showing that it was an innocent purchaser for value was upon Prudential. In regard thereto there are certain aspects of the evidence which are pertinent to consider. The first of these is that the 'Home Modernization Contract' is a printed form which, in the usual 'fine print' includes the name of Prudential Federal Savings as the assignee. Similarly, it recites that the assignee accepts the contract 'with recourse.' These circumstances might reasonably lead one to believe that the assignee had something to do with the planning of this transaction and knew the facts concerning the collateral contracts, and that it was advisedly attempting to avoid any involvement of itself therein, but without regard to what effect those contracts may have upon the purchasers. Finally, and most important, is the fact that there was a substantial alteration on the face

> of the assigned contract in the name of the payee, from Guardtone of Utah to Guardtone, Inc., a circumstance which should put a prudent purchaser on inquiry. No such inquiry was made.
>
> From the facts recited herein it is our opinion that there is a basis in the evidence upon which the jury could fairly and reasonably refuse to believe that the defendant Prudential Federal was an innocent purchaser and which supports the conclusion that it was bound by the judgment rescinding the contract for fraud. We have heretofore pointed out the importance of affording parties who desire it a trial by jury; and that the courts should exercise caution and reluctance in interferring with them. It is our view that the judgment should be in accordance with the jury verdict and the case is remanded for that purpose.

In the instant case the court found that the property was obtained by fraud from the Robertsons. Moreover, it is submitted that the evidence in the instant case is far stronger that Intermountain was not a bona fide or innocent mortgagee than was the evidence against Prudential's innocent assignee status in the *Schow* case. It is also to be noted that the court in the Schow case indicates that fraud having been established, that the burden was on the assignee to show that it was an innocent purchaser for value. In the instant case, the trial court did not go that far, but rather put the burden of proof upon the plaintiffs. Even having done so, it still found that Intermountain Capital was not an innocent mortgagee for value and without notice or that in the alternative that a trust had been established by which Smith held the property and that Intermountain took subject to the terms of that trust.

Under Point I of its brief, Intermountain Capital appears to attach some significance to the fact that the Robertsons held the Memorandum Trust Agreement (Ex. 2-P) for a few days before they signed it and that they ultimately did sign even though certain changes promised by Geis had not been incorporated into it. Intermountain's brief does not point out just what these supposed changes were supposed to have been or what difference they are supposed to make in this case. As a matter of fact, the Robertsons did wait a few days before signing the agreement, but there should be no significance to that fact insofar as the outcome of this case is concerned. The agreement as signed plus the oral misrepresentations that the court found that Geis made and of which Whiteley was aware before his company loaned the money, are more than ample to justify the trial court's decision that Intermountain Capital was not a bona fide mortgagee for value and without notice or its alternative decision on a trust theory.

In its brief, Intermountain cites four cases generally for the proposition that where one of two innocent parties must suffer, the loss should fall on the one who created the circumstances making it possible for the wrong to be accomplished. These cases cited by Intermountain were: *Allred v. Hinkley,* 8 U.2d 73, 328 P.2d 726 (1958); *Harrison v. Auto Security Company,* 70 U. 11, 257 P.677 (1927); *Leherberg v. Felopulous,* 248 N.E. 2d 648 (1969) and *Lesser v. Strubbe,* 171 A.2d 114 (1961). Plaintiffs have no quarrel with that proposition and, as stated above in this brief, it acknowledges that if Intermountain had, in fact, been innocent, that the Robertsons rather than it should

bear the loss. The facts in the instant case are completely different from any of those in the four cases just cited and they therefore offer no precedent for deciding this case.

POINT II

PLAINTIFFS' JUDGMENT AGAINST DEFENDANTS GEIS AND SMITH, BASED ON FRAUD, IS FULLY SUPPORTED BY THE EVIDENCE IN THE RECORD.

The trial court granted plaintiffs a judgment against the defendants Donald W. Geis and Sloan Smith, based on their fraud as against the plaintiffs, for $3,758.31 plus interest thereon at the rate of 6% per annum from December 15, 1964 to the date of judgment and thereafter at the rate of 8% per annum. The trial court arrived at that particular figure based on the following computation. It found that said defendants Geis and Smith had agreed to pay the plaintiffs $2,500.00 per year, less the property taxes, during the period of time that the plaintiffs' property was deeded to them. This period went from May 2, 1963 when the property was deeded to Geis until December 15, 1964 when First Dividend recorded the deed back to the plaintiffs, subject to the Intermountain mortgage. During this period of time, the defendants had paid $300 for taxes. Computing the amount due at an annual rate of $2,500.00, there would be due to the plaintiffs a total of $4,058.31 and subtracting the $300.00 paid for property taxes, left the amount of $3,758.31, for which amount the court granted the plaintiffs' judgment.

The trial court also provided in its judgment that if, as a result of any appeal, the judgment voiding the Intermountain mortgage was itself set aside, that then the plaintiffs would be granted an additional judgment against the defendants Geis and Smith for $42,500.00. Obviously, and under the damage rule for fraud that will be hereafter referred to, the plaintiffs' damages as against the defendants Geis and Smith would be increased in that amount and in the event that this court reversed plaintiffs' judgment against Intermountain and plaintiffs thereby lost the property.

On this particular point, the defendant Intermountain states in its brief on page eight that the "lower court anticipated that his decision concerning the validity of the mortgage might be overturned" by providing this additional amount of $42,500.00 in damages and in the event that its decision voiding the mortgage were set aside by this court. It is submitted that it is unfair to state that the trial court "anticipated" any such result. As noted above under Point I of this brief, the trial court's decision to void the mortgage is amply supported by the law and the evidence and, in fact, and considering the findings of fact that the trial court made upon the disputed evidence, this was the only decision it could have made. Nevertheless, it would be unrealistic for the trial judge to suppose that he was infallible and that no part of his decision could be reversed or altered on appeal. Since it is possible that all or part of the decision could be reversed, that being the prerogative of this court, the trial court was prudent enough to provide what the damages would be in the event of a reversal.

It further bears statement on this subject matter that the plaintiffs and third-party defendants' main interest in this litigation from its inception has been to void Intermountain's mortgage as against their property. For reasons that must be apparent to the court upon a review of the record and a reflection upon the testimony of defendants Geis and Smith, any judgment in favor of the plaintiffs and as against those persons is undoubtedly worthless.

Counsel for plaintiffs acknowledges that in proving a claim for fraud that there are a number of elements, all of which must be proven, and that the burden is upon the one claiming the fraud to prove the same by clear and convincing evidence. In the case of *Stuck v. Delta Land & Water Co.,* 63 U. 495, 227 P. 791, the court set forth the basic elements of a fraud case and these elements have been adhered to by the Utah Supreme Court since that time. These elements are: "(1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or ignorance of its truth; (5) his intent that it should be acted upon by the person and in the manner reasonably contemplated; (6) the hearer's ignorance of its falsity; (7) his reliance upon its truth; (8) his right to rely thereon; (9) his consequent and proximate injury." See also *Pace v. Parrish,* 122 U. 141, 247 P.2d 273; *Oberg v. Sanders,* 111 U. 507, 184 P.2d 229; *Davis Stock Co. v. Hill,* 2 U. 2d 20, 268 P.2d 988.

In a fraud case, Utah has adopted the rule allowing the "benefit of the bargain" in damages rather than the "out-of-pocket" rule adopted by the Restatement of Torts,

Section 549. On this point, see *Prudential Oil & Minerals Co. v. Hamlin,* 277 F.2d 384 (10th Cir.); *Pace v. Parrish; supra.; Beaver Drug Co. v. Hatch,* 61 U. 597, 217 P. 695; and *Woodmont, Inc. v. Daniels,* 274 F.2d 132 (10th Cir.). Using this rule, the trial court arrived at the damages award as against the defendants Geis and Smith that is referred to above.

Even though the defendants Geis and Smith did appeal in this case from the judgment against them and in favor of the plaintiffs, no briefs for them have yet been filed in this case. It is therefore unknown upon what grounds their appeal might be based. Plaintiffs' counsel respectfully submits that there is no grounds for appeal or for reversal on the part of these defendants and it is very evident from the record that all of the elements of fraud referred to above were proven by the plaintiffs and that the trial court was justified in finding fraud, as he did, by clear and convincing evidence.

The major factual points upon which the court relied are set forth above in this brief under "Statement of Facts" and will not be repeated here. It is true that certain of the representations made by Geis for Smith to the plaintiffs and to induce them to give up their property were promissory in nature and might not therefore serve, themselves, as a basis for a finding of fraud as against the defendants Geis and Smith. However, there were certainly many representations made which were not promissory in nature and which constituted misrepresentations of then existing material facts. For example, representations were made about the success of the business up to that time in Cen-

tral America that the trial court from the evidence could well have determined were false and were known to be false at the time made. The defendants also represented to the plaintiffs a number of things about the way their property would be handled. For example, the defendants represented that they would put no greater lien against the property than for $25,000.00, and they would not tie up the property for more than ten years and that they would not tie it up in such a fashion that parcels could not be released from it. There was ample evidence to justify the trial court in believing that all of these representations by the defendants were false when made and that defendants Geis and Smith then knew this.

CONCLUSION

On somewhat disputed evidence and after the most conscientious review of both the evidence and the law, the trial court sitting as the trier of fact, without a jury, found that all of the elements of fraud had been committed by the defendants Geis and Smith as against the plaintiffs and in obtaining their property from them. After a similar review, the court found that the defendant Intermountain, although not actually a party to the fraud, had knowledge and notice of most of the material portions of the transactions as between the defendants Geis and Smith on one hand and the plaintiffs on the other hand. The court further found that the defendant Intermountain through its president, Whiteley, knew of the limitations by which the defendants Geis and Smith had obtained the property from the plaintiffs and knew this before it loaned its $60,000.00

and took the mortgage. Based on this evidence and the law, the trial court found fraud on the part of the defendants Geis and Smith and that the defendant Intermountain was not a bona fide mortgagee for value and without notice or that, in the alternative, it took the mortgage subject to the terms of the trust agreement by which the defendants Geis and Smith had obtained the property from the Robertsons. Accordingly, the court granted damages to the plaintiffs as against the defendants Geis and Smith for fraud and a further judgment to the plaintiffs and third-party defendants voiding the mortgage held by Intermountain against their property.

The trial court having found and held as it did, its decision must be affirmed if supported by competent evidence. The evidence in support of its decision was not only competent, but overwhelmingly in favor of the plaintiffs, and it is respectfully submitted that the Supreme Court should affirm in full the findings, conclusions and judgment of the trial court.

Respectfully submitted,

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CERTIFICATE OF MAILING

I hereby certify that I mailed two copies of the foregoing brief to Gerald L. Turner, 2525 South Main, Suite 14, Salt Lake City, Utah 84115; to L. Delos Daines, 822 Kearns Building, Salt Lake City, Utah 84101 and to Walter P. Faber, Jr. and R. Bruce Gordon, 606 Newhouse Building Salt Lake City, Utah 84111 this ...28... day of June, 1973.

DAVID K. WINDER