UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

ARDEN ROYCE MORRIS,
PHYLLIS JEAN MORRIS,
dba Morris Construction,
Debtors,

Case No. 85-2722-W

Adv. Pro. No. 86-0068

TITLE GUARANTY COMPANY,

Plaintiff,

v.

ARDEN ROYCE MORRIS,
PHYLLIS JEAN MORRIS,

Defendants.

MEMORANDUM OF DECISION AND ORDER

On January 5, 1987 a trial on plaintiff's complaint to determine dischargeability of debt was held before this court in Council Bluffs, Iowa. Plaintiff, Title Guaranty Company, filed a complaint under 11 U.S.C. section 523(a) asserting that the debt in question is nondischargeable due to alleged fraud perpetrated by the debtors/defendants. Curtis J. Heithoff appeared on behalf of the plaintiff. Donald G. Furlow appeared on behalf of the defendants.

This is a core proceeding pursuant to 28 U.S.C. section 157(b)(2)(I). Having reviewed the record and the briefs submitted by the parties and being fully advised in the premises, the court makes the following findings of fact and conclusions of law pursuant to R. Bankr. P. 7052.

FINDINGS OF FACT

In the order on pretrial conference filed May 20, 1986, the parties agreed that the following facts may be accepted as established:

1. In 1983 the defendants, Arden and Phyllis Morris, contacted realtor Lyle Edward Cain to sell their home at 750 North 26th Street in Council Bluffs, Iowa.

2. After approximately seven or eight months, Richard and Beverly Clark made an offer to purchase the property.

3. The plaintiff Title Guaranty Company, was hired by both the buyers and sellers to assist in the closing of the transaction. The buyers further instructed the plaintiff to issue a title insurance policy on the property.

4. The real estate was encumbered by two mortgages -a first mortgage to First Federal Savings and Loan Association with an approximate balance of $8,000 and a second mortgage to Avco Finance with an approximate balance of $9,450.00.

5. In preparing the closing statement and title insurance policy, the plaintiff overlooked the mortgage to First Federal Savings and Loan. Thus, the final real estate closing statement and title insurance policy failed to list the mortgage as an exception.

6. The plaintiff gave the closing statement and other paper work to the realtor, Mr. Cain, who was to close the transaction. On March 26, 1986, Mr. Cain presented the closing statement to the defendants at their home. The

defendants signed the statement and received a check in the amount of $27,330.52.

7. Some time after the closing, the defendants received a late payment notice from First Federal Savings and Loan and discovered that the lien had not been discharged.

8. The plaintiff demanded that the defendants satisfy the mortgage, but the defendants refused to do so. on August 8, 1984 the plaintiff paid First Federal Savings and Loan the amount owing and took an assignment of both the mortgage and note. The plaintiff filed suit in Pottawattamie County District Court on October 8, 1984 in an attempt to collect the amount due on the note.

9. The defendants filed their Chapter 7 bankruptcy petition on December 13, 1985.

10. On March 24, 1986 the plaintiff filed this complaint to determine dischargeability of debt.

APPLICABLE LAW AND ANALYSIS

Plaintiff's complaint does not specify upon which particular section of 11 U.S.C. section 523(a) it relies for a determination of dischargeability. The Bankruptcy cover sheet, however, indicates plaintiff's reliance on section 523(a)(2). Section 523(a)(2) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) ofthis title does not discharge an individual debtor from any debt--

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
> >
> > (B) use of a statement in writing--
> >
> > > (i) that is materially false;
> > >
> > > (ii) respecting the debtor's or an insider's financial condition;
> > >
> > > (iii) on which the creditor to whom the debtor is liable for such money,, property, services, or credit reasonably relied; and
> > >
> > > (iv) that the debtor caused to be made or published with intent to deceive; or

Section 523(a)(2) divides all statements into two mutually exclusive categories. Section 523(a)(2)(A) includes acts or statements, even those made orally, but excludes oral statements regarding a debtor's financial condition. See In re Roberts, 54 B.R. 765, 770 (Bankr. N.D. 1985). Section 523(a)(2)(B) governs only written statements concerning a debtor's financial condition. See, id.; In re Simpson, 2 9 B.R. 202, 207-208 (Bankr. N.D. Iowa 1983).

While plaintiff's complaint does not specify upon which subsection 523(a)(2) it relies, the complaint alleges that the defendants' conduct "amounted to fraudulent and intentional

misrepresentation and an effort on their part to defraud the plaintiff." Moreover, in its brief the plaintiff states

> (t]his is not a case of where a potential borrower obtained money from a lending institution based upon some kind of alleged misrepresentation of its economic situation. This is a simple case of a company making an honest mistake in the handling of a large amount of money, with the creditor [sic) knowingly taking full advantage of the mistake and walking-away with $8,000.00 of the creditor's money.

This court agrees that the defendants' signatures on the closing statement prepared by the plaintiff does not meet the requirement of a writing concerning the debtor's financial condition under section 523(a)(2)(B). See In re Bonefas, 41 B.R. 74, 78 (Bankr. N.D. Iowa 1984). Therefore, the court turns to an analysis under section 523(a)(2)(A).

For a debt to be nondischargeable under section 523(a)(2)(A), the plaintiff must prove that: (1) the debtors made false representations; (2) at the time the representations were made the debtors knew they were false; (3) the debtors mad e the representations with the intent to deceive the creditor; (4) the creditor relied upon such representations; and (5) the creditor sustained the alleged loss and damages as a proximate result of the false representation. In re Bonefas, 41 B.R. at 78, citing In re Houtman, 568 F.2d 651, 655 (9th Cir. 1978). To prevail on a section 523(a)(2)(A) complaint, the plaintiff has the burden of proving each of these elements by clear and convincing evidence. Bonefas, 41 B.R. at 78.

The plaintiff initially contends that the defendants' signatures on the closing statement constituted a representation. Since the omission of the mortgage to First Federal Savings & Loan rendered the closing statement inaccurate, the plaintiff asserts that the defendants' failure to disclose the inaccuracy constituted a representation that was false. Some courts have found the failure to disclose a particular fact to be an implied representation and sufficient to establish the first element under section 523(a)(2)(A). See In re Bailey, 35 B.R. 224, 227 (Bankr. E.D. Va. 1983); In re Pommerer, 10 B.R. 935, 939 (Bankr. Minn. 1981).

The plaintiff next contends that at the time of the closing the defendants knew the closing statement was inaccurate and that they intended to deceive the plaintiff by signifying the statement's accuracy. Although intent to deceive may be inferred from the circumstances of the case, such a finding of intent generally requires a showing that the defendants knew or should have known of the falsity of their statement. In re Valley, 21 B.R. 674, 679-80 (Bankr. Mass. 1982). In assessing the defendants' knowledge and liability for fraud, the court will scrutinize acumen and experience of the defendants. In re Newark, 20 B.R. 842, 857 (Bankr. E.D.-N.Y. 1982).

At trial the defendants maintained that they did not know that the closing statement was incorrect at the time of the closing. Both defendants admitted that they did not carefully read or truly understand the various items listed

on the real estate closing statement. Mr. Morris recalled asking the realtor about a $3.00 late charge from First Federal and the realtor responding "the house is no longer yours, it's been paid, the house belongs to the Clarks." The defendants therefore believed that all liens had been discharged and that the proceeds check represented what was left over. Both defendants testified that several months after the closing they received late payment notices from First Federal. When they contacted their realtor, he again assured them that the mortgage had been paid and that the notices were probably due to computer error. only after receiving a foreclosure notice did it become apparent that the mortgage had not been discharged.

This court finds the defendants' testimony sufficiently credible to negate the plaintiff's allegation of fraudulent intent. The defendants are simple people. The real estate transaction in question was complex, even by the realtor's standards. The defendants clearly relied upon the expertise of their realtor and of the plaintiff at every stage of the transaction. They believed that the closing statement prepared by the plaintiff was accurate, as did their realtor. The plaintiff therefore has failed to establish by clear and convincing evidence that the defendants knew the statement was false and intended to deceive the plaintiff.

While the above finding is sufficient to declare the debt in question dischargeable, this decision will address the plaintiff's alleged reliance on the defendants'

representation. A creditor's reliance on a false representation must in any case be reasonable. In re Kelley, 51 B.R. 707, 709 (Bankr. S.D. Ohio 1985). The determination of reasonableness is made from a consideration of all the facts and circumstances. In re Martin, 761 F.2d 1163, 1166 (6th Cir. 1985). Relevant facts include the size of the transaction, prior business dealings between the parties, action taken by the creditor to investigate the debtor, and sophistication of the creditor. Id. at 1166-67; see In re Salvatore, 46 B.R. 247, 251 (Bankr. R.I. 1984). Reasonable reliance may also be determined by comparing the creditor's normal business practices and the standards of the industry to the existing circumstances. In re Bonefas, 41 B.R. 74, 79 (Bankr. N.D. Iowa 1984).

In this case several factors weigh against finding that the plaintiff's reliance was reasonable. The plaintiff is in the business of performing abstracting services, conducting closings and preparing title reports. Dean Junker, the owner of the plaintiff business, testified that he has performed approximately 1,500 real estate closings. Mr. Junker stated that he was hired to do the closing for the defendants and to provide title insurance for the buyers and the lender. In preparing a title insurance policy and closing statement, Mr. Junker explained that his company searches all the records at the county courthouse and pulls together all the information affecting the property.

In the real estate transaction in question, Mr. Junker testified that his company searched the geographical index maintained in his office rather than the records maintained at the courthouse. Mr. Junker admitted that a card in that index had been misfiled and therefore the plaintiff did not discover the mortgage to First Federal Savings and Loan. Mr. Junker testified that he did not personally conduct the closing in this case; in fact, he stated he had never met with the defendants. Rather, the paper work was given to the realtor who was to meet with the defendants and conduct the closing. Only after Mr. Junker was told that the defendants had received delinquent notices from First Federal did he direct his employees to go through the courthouse records. The mortgage to First Federal was then discovered. Mr. Junker further testified that he paid the mortgage to First Federal because he had agreed with the lender and the buyer to insure them against any loss.

In light of the foregoing, the court finds that the plaintiff's reliance upon the defendants' signatures on the real estate closing was unreasonable. The plaintiff was in a superior position to protect its interest and could have insured accuracy with a minimal amount of due care. See In re Routon, 69 B.R. 39, 40 (Bankr. E.D. Mo. 1986) (no reliance on part of bank that prepared closing documents containing an error, despite debtors' knowledge of the error); In re Landon, 37 B.R. 568, 571 (Bankr. N.D. Ohio 1986).

Finally, the defendants request an award of attorney's fees and costs of this action pursuant to 11 U.S.C. section 523(d). Section 523(d) provides:

> (d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

A consumer debt is defined in 11 U.S.C. Section 101(7) as a "debt incurred by an individual primarily for a personal, family, or household purpose." The debt at issue here was not a consumer debt. Therefore costs and attorney's fees are not recoverable under section 523(d). In re Walters, 50 B.R. 521, 522 (Bankr. Del. 1985).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing facts, applicable law and analysis, the court concludes that the plaintiff has failed to prove by clear and convincing evidence that the defendants knowingly and intentionally made a false representation upon which the plaintiff relied.

THEREFORE, IT IS ORDERED that the debt in question is dischargeable.

It is further ORDERED that the parties shall each be responsible for their own attorneys' fees and costs.

Signed and filed this 30th day of March 1987.

LEE M. JACKWIG

U.S. BANKRUPTCY JUDGE