IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF IOWA

IN RE:)
) Chapter 7
MICHAEL M. KRUGER)
DIANA D. KRUGER,)
)
Debtors.) Bankruptcy No. 01-01666
---------- STEVEN G. SCHMITZ,)
) Adversary No. 01-9168
Plaintiff,)
)
vs.)
)
MICHAEL M. KRUGER)
DIANA D. KRUGER,)
)
Defendants.)

ORDER

On May 7, 2002, the above-captioned matter came on for trial. Plaintiff Steven Schmitz appeared with Attorney Edward Gallagher, Jr. Debtors/Defendants Michael and Diana Kruger appeared with Attorney Don Gottschalk. Evidence was presented after which the Court took the matter under advisement. Briefs are now filed and the matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

FINDINGS OF FACT

Debtor Michael Kruger acquired three lots locally known as 1800, 1804, and 1806 Falls Avenue, Waterloo, Iowa, through a land sale contract. Debtor lived in a house located at 1804 Falls Avenue. The property located at 1806 Falls Avenue contained a garage rented by Plaintiff. Plaintiff and Debtor became friends. They periodically helped each other. Plaintiff testified that he came to trust Debtor.

Debtor's business was involved in loan transactions with Union Planters Bank (the "Bank"). On July 15, 1997, the Bank granted a business loan to Debtor. Debtor secured this loan by assigning his interests in the land sale contract covering the property at 1800, 1804, and 1806 Falls Avenue. The assignment consisted of a written document prepared by the Bank which described the property as lots 388, 389 and 390 in Galloway
Addition in the City of Waterloo, Iowa. The assignment did not list the properties by their street addresses of 1800, 1804 and 1806 Falls Avenue.

On or near November 5, 1997, Plaintiff approached Debtor about buying the garage property he was renting at 1806 Falls Avenue. Debtor testified his initial response to the proposal from Plaintiff was that he would think about it. This conversation took place after Debtor executed the assignment of his land sale contract rights to the Bank.

According to Debtor, he later approached Plaintiff about Plaintiff's purchase of the property. Debtor recalls part of the conversation included remarks to Plaintiff that Debtor was in tax trouble and needed money. Debtor told Plaintiff that the property had a clean title.

In late November, 1997, Debtor agreed to sell the property to Plaintiff for $10,000. The parties determined that the purchase price would be paid in six installments with the first payment to be made December 3, 1997 and the last payment to be made June 15, 1998. This sale occurred without the input of legal

counsel. The actual sale document is on a business invoice form. It merely states that 1806 Falls Avenue was being sold to Steve Schmitz for $10,000. (Exhibit 1). Plaintiff made the requisite payments to Debtor with the final payment occurring on June 1, 1999. After making the last payment Plaintiff asked Debtor about receiving title for the property.
Debtor signed a Warranty Deed to Plaintiff which Plaintiff received in January of 1999. The Bank later contacted Plaintiff and informed him that the Bank had a lien on the 1806 Falls Avenue property.

Debtor denies knowing he assigned his interest in the 1806 Falls Avenue property to the Bank prior to the sale. Upon being shown the assignment, Debtor agreed that the contract did cover the property, as it covered all three of his lots on Falls Avenue. Debtor testified that, prior to the sale, he called the abstract company and was advised that there was no lien on 1806 Falls Avenue. This opinion was allegedly given over the phone and was never reduced to writing. Debtor could not identify the exact date of the purported conversations or the identity of the person from the abstract company to whom he spoke.

Timothy Reilly, a vice-president and long time employee of Black Hawk County Abstract Company, gave an evidentiary deposition on May 3, 2002. He testified that it was the policy of the abstract company to refuse to provide verbal opinions

over the telephone concerning the status of liens on property. Mr. Reilly stated that the company has from time to time reprimanded employees for such actions.

Debtor also testified that a conversation with Tim Mack, a loan officer for the Bank, further assured him that the property was free of encumbrances. Debtor claims that after he called the abstract company he met with Mr. Mack regarding his business and indicated that he was interested in selling the 1806 Falls Avenue to Plaintiff. Mr. Mack raised the question whether the Bank had a lien on the property. Debtor said he told Mr. Mack that the abstract company told him that there was no lien on the property and that Mr. Mack said it was "ok".

Mr. Mack testified by deposition that he handled loan files involving Debtor and Debtor’s corporation. He recalls one conversation with Debtor where sale of the garage was mentioned but does not recall any discussion regarding the status of liens on the property.

Ultimately, the Bank foreclosed on the property. On
July 9, 2001 a settlement was reached between Plaintiff and the Bank. Plaintiff agreed to pay $6,000.00 to the Bank to have the lien released. Plaintiff wishes to recover the $6,000 plus attorney fees and costs from Debtor. Debtor filed a bankruptcy petition on May 8, 2001.

STATEMENT OF THE CASE

Plaintiff asserts this debt should be excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A) based on false representations. Debtor denies this allegation and asks that the obligation be discharged.

CONCLUSIONS OF LAW

Plaintiff asks for a finding that this debt is nondischargeable pursuant to § 523(a)(2)(A). This section provides in pertinent part:

> (a) A discharge under section 727 . . . 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--

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(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. § 523(a)(2)(A) (2002).

Plaintiff must prove the elements of his claim under § 523(a) by a preponderance of evidence. Grogan v. Garner, 498 U.S. 279, 285 (1991). Exceptions to discharge must be "narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code. These considerations, however, 'are applicable only to honest debtors.'" In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987).

In the Eighth Circuit, a creditor proceeding under §523(a)(2)(A) must prove the following elements: (1) the debtor made representations; (2) at the time made, the debtor knew them to be false; (3) the representations were made with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on the representations; and, (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. In re Ophaug, 827 F.2d 340, 342 n.1 (8th Cir. 1987), as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that "§ 523(a)(2)(A) requires justifiable, but not reasonable, reliance").

It is undisputed that Debtor made a representation that the property being sold to Plaintiff had clear title. Debtor testified that he told Plaintiff that there were no liens on the property. The task is to determine whether Plaintiff has proven the remaining elements.

False Representations

A determination of nondischargeability under § 523(a)(2)(A) requires a finding that Debtor knew that the representations were false at the time he made them. In re Gramolino, 183 B.R. 565, 567 (Bankr. E.D.Mo. 1995). This standard is derived from the requirement that only actual fraud, and not fraud implied in law, satisfies § 523(a)(2)(A). Ophaug, 827 F.2d at 342. A false representation made under circumstances where a debtor should have known of the falsity is one made with reckless disregard for the truth. This satisfies the knowledge requirement. Id. The court must focus on whether the surrounding circumstances or the debtor's actions appear so inconsistent with self-serving statements of intent that the

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proof leads the court to disbelieve the debtor. Palmacci v. Umpierrez, 121 F.3d 781, 789 (1st Cir. 1997).

This case hinges on what Debtor knew concerning the title of the land when he sold it on contract to Plaintiff in November 1997. Debtor testified he believed he owned the land free and clear of all liens. In weighing the credibility of witnesses, the Court must examine the evidence presented and evaluate the testimony, including variations in demeanor as well as changes in the tone of voice. Anderson v. City of Bessemer, 470 U.S. 564, 575 (1985). The Court can assess credibility based upon the content of the testimony as well as the Court's own experience with the way people act. In re Carrigan, 109 B.R. 167, 170 (Bankr. W.D.N.C. 1989). Where two permissible views of the evidence exist, it is the responsibility of the Court to weigh the evidence presented including the credibility of the witnesses and make a choice between them. In re Waugh, 95 F.3d 706, 712 (8th Cir. 1996); In re Dullea Land

Co., 269 B.R. 33,
36 (B.A.P. 8th Cir. 2001) (discussing bankruptcy court's evaluation of evidence and credibility of witnesses).

Debtor assigned the real estate contract involving 1800, 1804, and 1806 Falls Avenue to the Bank in July of 1997 as collateral for a business loan. The assignment listed the legal description of the property by lot number but did not list the street addresses for the property. Debtor testified that when he decided to sell 1806 Falls Avenue to Plaintiff in November 1997, he checked with the abstract company and the Bank to determine if there were liens of record on 1806 Falls Avenue.

Debtor testified that he called the Black Hawk County Abstract Company and was advised by an employee that no liens existed. Debtor was unable to recall the name of the employee who provided this information. The Black Hawk County Abstract Company, through Timothy Reilly, testified that it was against company policy to give out information over the telephone regarding the status of liens. Mr. Reilly did concede that the company has from time to time reprimanded employees for such actions.

Debtor also claims that after he called the abstract company he talked with Tim Mack, a loan officer for the Bank. During their conversation Debtor indicated that he had an interest in selling 1806 Falls Avenue to Plaintiff. Mr. Mack raised the question of whether the Bank had a lien on that property. Debtor told Mr. Mack that the abstract company had informed him that the property was free of liens. Mr. Mack later testified that he recalled the conversation regarding the

sale of the property. He did not, however, recall discussing whether or not the Bank had a lien on the property. Debtor claims that the Bank did not advise him that they had a lien on the 1806 Falls Avenue property when he told the Bank he was selling the property.

Debtor asserts that the purported phone call to the abstract company, as well as his conversation with the loan officer, support his contention that he lacked knowledge of the lien upon the property in question. However, this testimony is suspect on several levels. First, while possible, it is improbable that an abstract company would provide a random caller with the type of information sought by Debtor. This assertion is suspect because, if for no other reason, an abstract company makes its living selling this type of information. It would be ill-served by providing it to unknown callers for free. Second, it is difficult to accept that a Bank would assure a customer, such as Debtor, that no lien existed on property without carefully referencing the appropriate loan documents to assure the accuracy of that statement. Finally, even if this Court were to accept those two statements as true, their accuracy does not exclusively support a finding of lack of knowledge. It, at least, equally supports the proposition that Debtor was aware that he had assigned his land contract to the Bank as collateral and that a lien existed upon it. Debtor's statements add substance to Plaintiff's contention that Debtor was aware of the existence of a lien and was checking records with the hope that the lien was not of public record. Under either interpretation, the evidence does not support Debtor's position. The evidence is inconsistent with Debtor's self-serving statement of intent to the extent that it leads the court to discredit his claims of lack of knowledge concerning the true state of title to the property.

Based on the entire record, this Court concludes that Debtor had recently encumbered the property in question and knew, or should have known, that the Bank had a lien on the property. Plaintiff has satisfied his burden to prove

that Debtor made a false representation with reckless disregard for the truth. This finding satisfies the knowledge requirement of §523(a)(2)(A).

Intent to Deceive

A plaintiff may present evidence of the surrounding circumstances from which intent may be inferred since direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain. In re Oligschlaeger, 239 B.R. 553, 556

(Bankr. W.D.Mo. 1999) (citing In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987)). "Intent to deceive will be inferred where a debtor makes a false representation and the debtor knows or should know that the statement will induce another to act." In re Duggan, 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994).

This Court concludes that Debtor had such intent. Debtor's statements as to the state of the title were, at a minimum, made in reckless disregard of the truth. Debtor knew that his statements would induce Plaintiff to purchase 1806 Falls Avenue at a price of $10,000. Had Plaintiff been apprised of the true state of the title, the purchase may not have been made or may have been made under different terms. This Court concludes that Debtor's false statement was intended to deceive Plaintiff into believing that the property which he wished to purchase was free and clear of encumbrances.

Reliance

Justifiable, not reasonable, reliance is required under §523(a)(2)(A). Field, 516 U.S. at 71. Whether reliance is justifiable is "a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than the application of a community standard of conduct to all cases." Id. The standard for showing justifiable reliance under § 523(a)(2)(A) is fairly low. In re Guske, 243 B.R. 359, 363 (B.A.P. 8th Cir. 2000).

Courts have found that a party may justifiably rely on a misrepresentation even when the party could have ascertained its falsity by conducting an investigation. In re Biondo, 180 F.3d 126, 135 (4th Cir. 1999). The Field case, which identified the standard, provides a cogent example of a seller of land claiming it to be free of encumbrances. A buyer's reliance on such a factual representation is justifiable, even if he could have "walked across the street to the office of the register of deeds in the courthouse" and easily learned of an unsatisfied mortgage. Field, 516 U.S. at 70 (quoting Restatement (Second) of Torts § 540 (1976)).

It is fair to conclude that Plaintiff's approach to the purchase of this land is not the recommended method. The purchase agreement was drafted on an invoice. Legal counsel was not consulted. Plaintiff did not seek an abstract or title opinion prior to purchase. Nevertheless, applying the reduced standard of Field, it is the conclusion of this Court that Plaintiff was not required to conduct an independent investigation into the current state of the title. Plaintiff

and Debtor were good friends, they had helped each other on various occasions, and had known each other for years.
Plaintiff testified that, for these reasons, he felt he could trust Debtor. Under the circumstances of this case, Plaintiff was justified in believing that he could rely on the representations made by Debtor.

Causation of Loss

Plaintiff expended $6,000 to have the Bank quit claim its interest in the property to him as a result of Debtor's failure to satisfy the Bank's claim. The purchase may not have been made or might have been made for a lower price if Debtor had correctly represented the title. Debtor's false representation was the proximate cause of any loss sustained by Plaintiff in relation to discharging the Bank's lien on the property.

Damages

Plaintiff seeks damages in the amount of $6,000. Plaintiff is entitled to damages which are the proximate result of conduct of the Debtor, Michael M. Kruger. He was required to pay $6,000 in order to obtain clear title to the property sold to him by Defendant Michael Kruger. The damages Plaintiff seeks are a fair measure of the damages proximately sustained by him.
Therefore, Plaintiff is entitled to receive, as the measure of damages, the sum of $6,000.

Plaintiff additionally seeks attorney's fees. Attorney's fees are recoverable only under limited conditions. They may be recoverable (1) if there is a statutory or written contractual provision allowing such an award; (2) if a defendant's conduct meets the appropriate definition of oppressive conduct; or (3) if, because of tortuous conduct of a defendant, a plaintiff is in good faith involved in litigation with a third party. Absent one of these three exceptions, a party has no claim for attorney's fees as damages. Hockenberg Equipment Co. v.
Hockenberg Equipment & Supply Co., 510 N.W.2d 153, 158 (Iowa 1993).

An examination of the conduct involved in this case, as applied to the exceptions which allow attorney fees, convinces this Court that attorney's fees are not recoverable. There is no written or statutory contractual provision allowing such an award. Debtor's conduct does not rise to the level of oppression or connivance necessary to satisfy an award of common law attorney's fees. Finally, since Plaintiff resolved the dispute with the Bank on his own, he was not required to be

involved in third-party litigation as a result of Defendant's conduct. Based on the foregoing, it is the conclusion of this Court that attorney's fees are inappropriate in this case and are not awarded as damages to Plaintiff.

WHEREFORE, it is the conclusion of this Court that Plaintiff has satisfied every element of 11 U.S.C.
§ 523(a)(2)(A) by a preponderance of evidence against Defendant Michael M. Kruger.

FURTHER, the Court finds that Plaintiff incurred $6,000 in actual damages

as a proximate result of the false representation made to Plaintiff by Debtor Michael M. Kruger.

FURTHER, judgment is entered in favor of Plaintiff Steven G. Schmitz and against Debtor Michael M. Kruger in the amount of $6,000.

FURTHER, the Court finds that there is no evidence of any false representation made by Debtor Diana D. Kruger and the claim made by Plaintiff Steven G. Schmitz against her is denied.

FURTHER, Plaintiff's claim is included in the discharge of Debtor Diana D. Kruger.

FURTHER, the Court concludes that Plaintiff Steven G. Schmitz has established his claim under § 523(a)(2)(A) against Michael M. Kruger and Plaintiff's claim against Debtor Michael M. Kruger is nondischargeable.

FURTHER, the costs of this action are assessed to Debtor Michael M. Kruger.

SO ORDERED this _9th_ day of July, 2002.

PAUL J. KILBURG
CHIEF BANKRUPTCY JUDGE