2001 BNH 024 **Note: This is an unreported opinion. Refer to AO 1050-1 regarding citation.**

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 00-12223-JMD
Chapter 7

Stephen F. Toy and
Karyn T. Toy,
Debtors

Alexander MacMillan, as Trustee
of The Dickson Family Revocable Trust,
Tracy Dickson, and Patricia Dickson,
Plaintiffs

v. Adv. No. 00-1118-JMD

Stephen F. Toy and
Karyn T. Toy,
Defendants

W.E. Whittington, Esq.
WHITTINGTON MELENDY & GIRDWOOD, P.C.
Attorney for Plaintiffs

Bruce R. Jasper, Esq.
ELLIOTT, JASPER, AUTEN & SHKLAR, LLP
Attorney for Debtors/Defendants

MEMORANDUM OPINION AND ORDER

I. INTRODUCTION

On April 16, 2001, the Court held a trial regarding a complaint filed pursuant to 11 U.S.C. § 523(a)(2). Evidence was presented by both parties, and at the end of the trial the Court took the matter under submission.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court

for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

In the 1980's Stephen and Karyn Toy (the "Debtors") subdivided a piece of property they owned in Sutton, New Hampshire into three lots. The Debtors sold the first and third lots and kept the second lot for themselves. When the Debtors conveyed lot number one to a third party in December of 1988 (the "1988 Deed"), the Debtors subjected lot two to a restrictive covenant in favor of the grantee of lot one. See Exhibit 3. Although the restrictive covenant was set forth in the 1988 Deed, it does not appear that any notice of the restrictive covenant was placed on record in the chain of title to lot two.

In December of 1990 the Debtors sold lot two to Tracy C. Dickson, III and Patricia E. Dickson (the "Dicksons"). Lot two was conveyed by a deed with warranty covenants (the "1990 Deed") and there was no mention of the restrictive covenant that had been previously placed upon lot number two by the 1988 Deed. See Exhibit 4. The Dicksons later learned of the restrictive covenant and sued the Debtors in state court for breach of the covenant against encumbrances contained in the 1990 Deed. On January 27, 2000, a jury returned a verdict on the breach of covenant claim in the amount of $80,000.00. See Exhibit 2.

On August 3, 2000, the Debtors filed a Chapter 7 bankruptcy petition. On September 6, 2000, Alexander MacMillan, as Trustee of The Dickson Family Revocable Trust, Tracy Dickson, and Patricia Dickson (collectively the "Plaintiffs") filed the above captioned adversary proceeding seeking to have the debt owed to them declared non-dischargeable pursuant to section 523(a)(2)(A). Prior to trial the parties had agreed that the only issue for the Court to decide was whether the debt was obtained by false pretenses, a false representation, or actual fraud.

The testimony at trial revealed that the Debtors had not seen the 1990 Deed prior to arriving at the bank for the closing with the Dicksons. The testimony also revealed that the Debtors did not examine the

deed prior to signing it and instead relied upon their attorney, Brackett Scheffy, to provide the proper documentation. Attorney Scheffy testified that he had in fact been the Debtors' attorney for a number of years and had prepared the 1988 Deed which contained the restrictive covenant placed upon lot two by the Debtors. He testified that he had inadvertently overlooked the restrictive covenant when he prepared the 1990 Deed.

The testimony of Karyn Toy revealed that in the prepetition state court suit she had testified that she knew the Dicksons thought they were purchasing an unrestricted piece of property. However, Karyn Toy also testified that she found the questioning in the state court proceeding to be very confusing and intimidating. When questioned during this adversary proceeding about what the Dicksons believed they were purchasing, Karyn Toy stated that she did not know what the Dicksons believed at the time of the closing.

III. DISCUSSION

Under 11 U.S.C. § 523(a)(2)(A) a debtor is not discharged from a debt for money to the extent that the debt was obtained by false pretenses, a false representation, or fraud. In order to be successful on this claim the Dicksons must prove the following six elements: (1) the Debtors made a false representation; (2) the Debtors did so with fraudulent intent; (3) the Debtors intended to induce the Dicksons to rely on the misrepresentation; (4) the misrepresentation actually induced reliance; (5) the reliance was justifiable; and (6) the reliance caused damage. See Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997). The Dicksons must prove each of the above elements by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 283, 291 (1991).

All of the elements necessary to except the debt in question from discharge under section 523(a)(2)(A) have been established except the second and third elements. The 1990 Deed contained a warranty that was not true because it omitted reference to the restrictive covenant created by the debtors when they delivered the 1988 Deed. The Dicksons testified that they relied on the 1990 Deed to the extent

that it did not refer to any restrictions or encumbrances on their use and enjoyment of lot two. The Dicksons were justified in relying on the warranty in the 1990 Deed. See Field v. Mans, 516 U.S. 59, 70 (1995). The prepetition state court suit established that a false representation was made and the amount of damages to the Dicksons. Therefore, the only elements left for the Dicksons to establish are (1) the Debtors made the false representation with fraudulent intent, and (2) the Debtors intended for the Dicksons to rely on the misrepresentation. "Fraudulent intent requires an actual intent to mislead, which is more than mere negligence." Palmacci, 121 F.3d at 788 (citations omitted). "A 'dumb but honest' defendant does not satisfy the test of scienter." Id.

In this particular case, the only evidence presented regarding the Debtors' fraudulent intent was Karyn Toy's testimony from the prior state court proceeding and the Debtors' failure to examine the deed conveying the property to the Dicksons prior to signing. The Court will first address the Debtors' failure to examine the deed prior to signing. As noted above, negligence will not suffice to prove fraudulent intent for the purposes of section 523(a)(2)(A). While the Debtors should have looked over the deed prior to signing it, and may have been negligent by failing to do so, the evidence at trial does not support a conclusion that the Debtors' conduct rises beyond the level of negligence. Accordingly, the Court finds that the mere failure of the Debtors to examine the deed prior to signing it does not rise to the level of actual intent.

The second piece of evidence relating to fraudulent intent is the prior testimony of Karyn Toy in the state court proceeding. The evidence at trial showed that in the prior state court proceeding Karyn Toy had testified that she knew the Dicksons thought they were purchasing an unencumbered piece of property. However, Karyn Toy testified in this proceeding that she had been confused and intimidated in the state court proceeding. Further, Karyn Toy testified that she did not know what the Dicksons thought they were purchasing. The Dicksons argue that Karyn Toy should not be allowed to so easily change her testimony.

The Court agrees that witnesses should not be able to change their testimony from proceeding to proceeding as it suits their needs. However, in this particular case there is no evidence to show that Karyn Toy's prior testimony was not simply a misunderstanding of the witness concerning the question that was

asked. The restrictive covenant in the 1988 Deed limited the placement of structures on lot two and effectively prevented the Dicksons from further subdivision of lot two into two building lots. However, there was no evidence that the Debtors ever orally misrepresented or concealed the restrictive covenant from the Dicksons, or that the Dicksons ever told the Debtors about any plans for the property. There was in fact no evidence presented regarding any pre-closing conversations between the Debtors and the Dicksons concerning any encumbrances on the property or the Dicksons' future use of the property. If Karyn Toy never spoke with the Dicksons about restrictions that the property was subject to or their plans for the property, how could she know that the Dicksons thought they were purchasing an unencumbered piece of property? The only way to form a belief about what someone else is thinking is by having conversations or negotiations with them about a particular transaction. Absent any evidence that Karyn Toy or her husband ever had discussions or negotiations with the Dicksons about the prospective future uses for lot two, or remained silent after the Dicksons made statements about future uses of the property in their presence, it would not be possible for Karyn Toy to form a belief about what the Dicksons did or did not believe. Accordingly, the Court finds that there is no reason to believe that Karyn Toy's prior testimony stemmed from anything but confusion on the part of a witness.

While Karyn Toy's prior testimony in state court would be evidence of the Debtors' fraudulent intent, Karyn Toy has testified differently before this Court, and has provided a reasonable explanation for the change in testimony. As such, the Court finds that at best the Plaintiffs' evidence with regards to fraudulent intent was equal to the evidence presented by the Debtors. Accordingly, the Plaintiffs have failed to meet their burden of proof for the element of fraudulent intent. As the Plaintiffs are required to prove each element of section 523(a)(2)(A) by a preponderance of the evidence, and have failed to do so with regards to the element of fraudulent intent, the Court need not address whether the Debtors intended to induce the Dicksons to rely on the misrepresentation.

IV. ORDER

For the reasons set forth in this opinion, the Plaintiffs have failed to meet their burden of proof with regards to their section 523(a)(2)(A) claim. Accordingly, the Dicksons' complaint is denied. The Debtors' obligation to the Dicksons is dischargeable. This opinion and order constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

DATED this 30th day of April, 2001, at Manchester, New Hampshire.

____
J. Michael Deasy
Bankruptcy Judge