NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. ID-06-1189-NBS
MICHAEL HARRISON and JULIE HARRISON,	BK. No. 04-02709
Debtors.	Adv. No. 04-06234
MICHAEL HARRISON,	
Appellant.	
v.	**M E M O R A N D U M**[1]
BARRY BALLEW,	
Appellee.	

Argued and Submitted on January 17, 2007
at Pasadena, California

Filed – March 29, 2007

Appeal from the United States Bankruptcy Court
for the District of Idaho

Honorable Jim D. Pappas, Bankruptcy Judge, Presiding

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Before: NAUGLE,[2] BRANDT and SMITH, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

[2] Hon. David N. Naugle, United States Bankruptcy Judge for the Central District of California, sitting by designation.

Michael Harrison ("Harrison") appeals from the judgment in favor of Barry Ballew ("Ballew") following trial in the bankruptcy court. Judgment in the amount of $59,930.35 was entered in favor of Ballew and against Harrison pursuant to § 523(a)(2)(A)[3] and excepted from the discharge of Harrison only.[4] Judgment was also entered in favor of Ballew and against Harrison pursuant to § 523(a)(6), from which Harrison does not appeal. Harrison argues that the bankruptcy court erred in finding that: (1) Ballew justifiably relied upon Harrison's representations under § 523(a)(2)(A); (2) Harrison's representations were the proximate cause of a state court judgment against Ballew in the amount of $33,738.79; and (3) Harrison was not entitled to an offset of damages. We AFFIRM.

FACTS

Harrison was in the business of real estate development, including buying land, building homes, moving homes and reselling properties. In 1994, he purchased several lots, including Lots 28 and 29 located off Petrie Street in Boise, Idaho. The lots were purchased in the name of Harrison's mother, Betty Harrison, due to Harrison's poor credit history.

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[3] Unless otherwise indicated, all "Code," chapter, and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 prior to its amendment by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23, as the case from which the adversary proceeding and this appeal arises was filed before its effective date (generally 17 October 2005). All Rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

[4] Julie Harrison was a defendant in the adversary proceeding; however, the bankruptcy court determined that the claims asserted against her were without merit, and judgment of dismissal was entered in favor of Julie Harrison and against Ballew.

Harrison split Lot 28, which created two lots instead of one. The second lot was known as a flag lot, which was described in the bankruptcy court's memorandum of decision as "consisting of a large rectangular parcel to the north connected by the 'pole' portion of the property to Petrie Street, thereby providing street access to the lot." He also owned 6819 Poplar and 6821 Poplar, which were located to the north of Lot 28. Harrison built improvements on Lot 28; however, the house encroached onto 6912 Petrie. He also built a guest house on Lot 28, known as 6904 Petrie. A home was moved onto 6912 Petrie, and Harrison obtained a permit to pour the foundation for 6912 Petrie and building permits to construct the house at 6900 Petrie and the guest house at 6904 Petrie. However, the plans failed to show that, because of a ditch on 6900 Petrie, the house on 6900 Petrie would encroach onto 6912 Petrie. The City of Boise inspected the construction and approved the same. Harrison failed to obtain approval for completion of the shared driveway and constructed the driveway without permit.

During this time, Harrison hired a land surveyor, Colleen Marks ("Marks"), who performed a survey. Harrison's goal in engaging Marks was to: (1) adjust the north/south lot line between Lots 28 and 29 to the center of the driveway; (2) combine 6819 Poplar, where the shop was located, with 6912 Petrie; and (3) adjust the lot line of 6821 Poplar.

Ultimately, the lot line between Lots 28 and 29 was never adjusted because Marks was told by Harrison to leave the lot line as is. The survey was limited to eliminating the property line between 6819 Poplar and 6912 Petrie and adjusting the property

line for 6821 Poplar. Harrison neither signed nor recorded the survey report. Marks made several failed attempts to contact Harrison about the status of the project and to record the survey. In October of 2001, Marks noticed a "sold" sign at 6821 Poplar and determined that the legal description in the conveyance was the same legal description which she had provided. Marks then recorded her survey report to protect herself under Idaho law.

Harrison and Ballew had been friends and business associates since approximately 1986. Ballew returned from Japan and sought Harrison's assistance in finding a residence. Ballew was interested in buying a home owned by Julie Harrison, which he had been renting (the "Frye Property"). Because Ballew was unable to obtain financing for the Frye Property, Harrison recommended that he purchase 6912 Petrie Street. Harrison represented that the flag lot, on which 6912 Petrie was located, included one-half of a common driveway and a garage, also known as a shop. Ballew raised questions regarding the lot lines and expressed concerns about the driveway access, location of trees and placement of irrigation ditches that were located on the property.

The property was appraised by Roger Jennings ("Jennings"), a real estate appraiser, who valued 6912 Petrie for Hopkins Financial ("Hopkins"), the lender. In reliance upon Harrison's representations, including the fact that the land, house and shop were located on one lot, Jennings valued 6912 Petrie at $129,000. At trial, he testified that 6912 Petrie would be worth

significantly less due to the property line and encroachment problems.[5]

Ballew bought 6912 Petrie for the purchase price of $130,000, which he believed included the house and the shop. He received credit for $8,000, which was the amount of his down payment on the Frye Property, borrowed $105,000 from Hopkins in exchange for a mortgage on 6912 Petrie, and signed a promissory note in favor of Julie Harrison for the approximate balance of $16,700, secured by a second deed of trust on 6912 Petrie.

A Residential Purchase Agreement ("Agreement") was presented to Ballew for the first time upon closing in September of 1999. With Ballew's permission, Harrison signed Ballew's name on the Agreement in the place of Buyer. Harrison added the language "as is where is without any warranties expressed or implied." Ballew was concerned at closing when he discovered the "as is" language as well as the fact that title to 6912 Petrie was held by Betty Harrison. Betty Harrison had granted Special Power of Attorney to Harrison to act on her behalf in selling 6912 Petrie, and she received no funds from the sale of 6912 Petrie. Although Ballew had concerns at closing, he completed the transaction and remained silent because Harrison had assisted him in obtaining the financing for 6912 Petrie. Further, Harrison provided Ballew with a warranty deed.

Immediately after closing, Harrison told Ballew that he noticed the legal description in the deed failed to include the

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[5] Jennings could not recall who met him at the property and showed him the boundary lines; however, the bankruptcy court concluded that there was no reason to believe that Jennings met with anyone other than Harrison, a reasonable inference.

shop property and assured Ballew that he would remedy this problem by deeding the property to him, but failed to do so. Ballew took possession of the home and the shop located on 6912 Petrie and began making improvements.

Lot 29 was lost in foreclosure in early 2000. Prior to the foreclosure, Julie Harrison, record title holder of Lot 29, executed an easement for use of the shared driveway in favor of Ballew because Harrison believed the easement was necessary. There is no indication that Ballew was aware of the easement giving him right of use to the shared driveway, nor any determination of the effect of the foreclosure on the newly granted easement.

In May of 2000, Julie Harrison transferred the note to Kim Kildew ("Kildew"). That summer Ballew observed survey stakes in the neighboring lot that appeared to designate a property line that did not meet with his understanding of the boundaries. He measured the boundary lines, drew a plat map and determined that title to 6912 Petrie was adversely affected by flaws and setback problems. Ballew remained silent about these concerns.

In January of 2001, Ballew stopped paying on the note to Kildew, and in November of 2001 he also stopped paying on the mortgage held by Hopkins. Kildew sent Ballew a Notice of Default in November of 2001, but failed to initiate foreclosure proceedings. Kildew sued Ballew in state court and obtained a judgment pursuant to stipulation ("State Court Judgment") against Ballew in the amount of $33,738.79. Ballew lived at 6912 Petrie from November 2001 through December 2003 without making any payments on the note or the mortgage.

Trial was held in the bankruptcy court. Ballew dismissed two of his claims at trial; the bankruptcy court entered judgment in favor of Ballew and against Harrison on the two remaining claims pursuant to § 523(a)(2)(A) and § 523(a)(6). The bankruptcy court also determined that Harrison was not entitled to an offset of damages. Judgment was entered in the amount of $59,930.35, and the amount was excepted from the discharge of Harrison. The bankruptcy court entered judgment of dismissal in favor of Julie Harrison and against Ballew.

On appeal, Harrison contends that the bankruptcy court erred in finding that: (1) Ballew justifiably relied upon Harrison's representations under § 523(a)(2)(A); (2) Harrison's representations were the proximate cause of the State Court Judgment under § 523(a)(2)(A); and (3) Harrison was not entitled to an offset of damages.

JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 1334 and § 157(b)(1) and (b)(2). This panel has jurisdiction under 28 U.S.C. § 158 (a)(1) and (b).

ISSUES

1. Whether the bankruptcy court erred in determining that Ballew justifiably relied upon Harrison's representations.
2. Whether the bankruptcy court erred in determining that Harrison's representations were the proximate cause of the State Court Judgment against Ballew in the amount of $33,738.79.
3. Whether the bankruptcy court erred in determining that Harrison was not entitled to an offset of damages

because Ballew failed to recover at trial for loss of equity.

STANDARD OF REVIEW

We review the bankruptcy court's finding of facts under the clearly erroneous standard and its conclusions of law de novo. In re Kirsch, 973 F.2d 1454, 1455 (9th Cir. 1992). Findings of fact shall not be set aside unless clearly erroneous. Fed. R. Bank. P. 8013. The clearly erroneous standard is applied to a determination of justifiable reliance, which is a question of fact. Id. A finding of proximate cause may be reversed only if clearly erroneous. Britton v. Price (In re Britton), 950 F.2d 602, 604 (9th Cir. 1991).

DISCUSSION

1. The Bankruptcy Court Did Not Err In Finding That Ballew Justifiably Relied Upon Harrison's Representations

Section 523(a)(2)(A) provides, in relevant part, that a debt for money, property, services, or an extension, renewal, or refinancing of credit is not discharged to the extent it was obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. To except a debt from discharge, a creditor must prove: (1) the debtor made the representations; (2) the debtor knew the representations were false at the time they were made; (3) the debtor made the representations with the intention and purpose of deceiving the creditor; (4) the creditor relied upon such representations; and (5) the creditor sustained the alleged loss and damage as the proximate result of the representations having been made. Britton, 950 F.2d at 604.

In this Circuit, a creditor must prove "justifiable reliance upon the representations of the debtor." Kirsch, 973 F.2d at 1460. This requires an examination of all circumstances as well as the subjective effect of the circumstances upon the creditor. Id. See also Restatement (Second) of Torts § 537(b)(1977)("The recipient of a fraudulent misrepresentation can recover against its maker for pecuniary loss if, but only if, (a) he relies on the misrepresentation in acting or refraining from action, and (b) his reliance is justifiable.").

Harrison argues that the standard applicable to Ballew's conduct is such that "... under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived, that he is required to make an investigation of his own." Field v. Mans, 516 U.S. 59, 71, 116 S.Ct. 437, 444-45, 133 L.Ed. 2d 351 (1995) (citations omitted). He further argues that "a person is required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation." Id. (citations omitted).

Harrison is correct that Field sets forth a subjective standard as to the characteristics of a particular plaintiff, as opposed to the "reasonable man" standard. Id. at 71. The record reflects that the bankruptcy court applied the correct standard.

Harrison argues that in Smith v. Young,(In re Young), 208 B.R. 189, 197 (Bankr. S.D. Cal. 1997), as here, the plaintiffs acted upon justifiable reliance "but only until they had

suspicion that else was in reality the case." Id. at 202. He contends that Harrison and Ballew were friends and business associates, had nicknames for each other, took extended trips abroad together and shared interest and knowledge about the other's personal life.

He further argues that the friendship does not justify reliance based upon Ballew's concerns that: (1) Harrison was able to move and build all of the structures on the properties, (2) access to the driveway, (3) location of the irrigation ditches and trees, (4) the original asking price of $139,000,(5) review of the Agreement for the first time at closing, (6) the "as is" language, and (7) access to the title report for the first time at closing, but failure to review the same. Harrison contends that this conduct is the kind of blind reliance noted in Field to be unjustifiable.

Smith was disapproved by Cohen v. De La Cruz, 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998). Harrison appears to cite the case for the proposition that plaintiffs therein and Ballew shared factual similarities, and like those plaintiffs, Ballew did not justifiably rely upon the representations of Harrison once certain suspicions were raised. We have also noted that the case is not good law in light of Cohen. Cobe v. Smith (In re Cobe), 229 B.R. 15, 18 (9th Cir. BAP 1998).

Ballew testified at trial:

> There was an urgency on all sides to get this deal closed. I was happy and grateful that he had assisted me in finding the financing, like I had previously testified that just getting a phone in my name seemed to be difficult-so I- there was a lot of paperwork, I didn't like a lot of what I was seeing, I was a little nervous,

> but I didn't feel like I needed to go hey, guys, you know what, I'm having second thoughts, maybe we ought to stop and let's look at all these papers, because, gosh, this, you know, doesn't feel really comfortable right now, because we're all the way down this road, the down payment money's been spent.

Trial Tr. at 170:3-12, Dec. 9, 2005.

The bankruptcy court made the following findings:

> Plaintiff was justified in his reliance on Mr. Harrison's representations as to the location of the property lines. Plaintiff and Mr. Harrison were good friends. There was nothing about the physical appearance of the property or location of the improvements that would have caused Plaintiff to doubt the truth of what Mr. Harrison had told him about the property boundaries. And nothing occurred prior to the closing that would have led Plaintiff to believe the property lines were other than as represented.
>
> The property was appraised for Plaintiff's lender based upon the erroneous boundaries Mr. Harrison had given to the appraiser, and a title insurance policy was issued. The only practical manner in which Plaintiff could have discovered Mr. Harrison's deceit was by his personal review of the recorded plats, something no one, including Mr. Harrison, would expect Plaintiff to do. The legal descriptions and the property's physical appearance comported with Mr. Harrison's representations. Plaintiff had no reason to question the boundaries, Mr. Harrison, the property's developer showed him.

Mem. Decision at 29-30, Feb. 10, 2006.

In 2000, prior to losing Lot 29 in foreclosure, Julie Harrison, at the request of Harrison, granted an easement to Ballew for use of the driveway. Although Harrison testified that he was not aware of the problem with the lot lines until 2001, the bankruptcy court concluded that Harrison's testimony was not credible, and he had contradicted his own prior testimony that he knew as early as 1996 that the house at 6900 Petrie encroached

onto 6912 Petrie. The bankruptcy court also concluded that, in all respects, the legal description and physical inspection of the property comported with Harrison's representations to Ballew.

That Ballew's reliance on the representation of Harrison was both subjectively and objectively reasonable is bolstered by several factors: Harrison was a sophisticate in the business of Idaho real estate development, i.e., buying, selling, building, splitting parcels, securing surveys, facilitating financing with outside lenders, like Hopkins, and making unconventional transactions with land titles and lending via his mother and his wife.

Ballew was a recent arrival from overseas, who even had difficulty securing new telephone service. When confronted with changes and deficiencies (like the "as is" clause and the shop/garage location), Harrison gave assurances to his friend that the problems would be corrected. In addition, as conceded by his counsel in argument, he gave a warranty deed. Ballew paid the $130,000, a good indication of subjective reliance.

The level of "justifiable reliance" has a fine point of distinction between the situation presented here under § 523(a)(2)(A) and an action under § 523(a)(2)(B), as explained in footnote 6 of the recent case of In re McGee, No. OR-06-1065, 2006 Bankr. LEXIS 3554, at *6 n.6 (9th Cir. BAP Dec.6, 2006). The reliance in the case before this panel is both justifiable and reasonable. The slightly more lenient standard under § 523(a)(2)(A) applies in this case.

The record does not reflect that any documents were produced at closing to remedy the misrepresentations made by Harrison

regarding the faulty setback, encroachments and defects in title upon which Ballew justifiably relied. The bankruptcy court determined that the only way Ballew could have discovered the falsity of Harrison's misrepresentations was to personally review the recorded plats, something that he was not required to do.

Under Idaho law, a transferor of residential real property is required to provide written disclosures. Idaho Code § 55-2504 ("Property Condition Disclosure Required") provides that any person who intends to transfer any residential real property complete the form as provided in Idaho Code § 55-2508, a Sellers' Disclosure Form, which sets forth, in relevant part:

> (6) Describe any condition that may affect your ability to clear title (such as encroachments, easements, zoning, violation, lot line disputes, etc.)

Idaho Code § 55-2508.

Harrison did not provide evidence at trial to prove that he made such disclosures, and the issue is not presently before the panel. Harrison does not argue that he made certain oral misrepresentations upon which Ballew justifiably relied, and then he made full disclosure in writing at closing in the Sellers' Disclosure Form or otherwise, which Ballew ignored. Presumably, had that been the case, Harrison would have raised the argument at trial and on appeal; he has failed to do so. Instead, he argues that, at closing, Ballew discovered the "as is" language and was given access to the title report for the first time and failed to review the same. Under the circumstances, the bankruptcy court's finding that Ballew's reliance was justified is not clearly erroneous.

2. The Bankruptcy Court Did Not Err In Determining That Harrison's Representations Were The Proximate Cause Of The State Court Judgment Against Ballew In The Amount Of $33,738.79

To prevail on a § 523(a)(2) claim, the creditor must prove that he sustained the alleged loss and damage as the proximate result of the representations having been made. Britton v. Price (In re Britton), 950 F.2d 602, 604 (9th Cir. 1991).

Under Idaho law, proximate cause "has been defined as a cause which in natural and continuous sequence, unbroken by any efficient intervening cause, produces the result complained of and without which the result would not have occurred." Edward Motors, Inc. v. Twin Cities Toyota, Inc., 111 Idaho 846, 849, 727 P.2d 1274 (Idaho Ct. App. 1986).

The bankruptcy court determined that all the money Ballew owed to Kildew was a direct consequence of Harrison's fraudulent actions. It further stated that had the note not been transferred, Ballew could have been relieved from any further obligation under the note.

In Britton, the debtor was an office manager who led patients to believe that he was a medical doctor and committed fraud in convincing a patient to submit to surgery. The Ninth Circuit determined that malpractice is a foreseeable consequence of any improper medical procedure. There was no policy argument to limit the extent of Britton's liabilities for the patient's injuries. Britton, 950 F.2d at 604. In this case, the bankruptcy court determined that "[i]t is of no significance that Plaintiff failed to make the payments on the note, or that he incurred

additional obligations for interest, attorney fees and costs under that note." Mem. Decision at 32, Feb. 10, 2006.

Where a seller of real property makes misrepresentations as to the condition of the real property to induce a buyer to purchase the real property, the consequence of such fraudulent transaction when the buyer discovers the true condition thereof, may be that the buyer ceases making payments on the mortgage as well as the note securing a second deed of trust on the real property resulting in a judgment against the buyer.

Of course, it is also a foreseeable consequence that a buyer, upon discovering the defects, may continue to pay the obligations and initiate litigation against the seller; however, that is not the only foreseeable consequence of such misrepresentation. As in Britton, there is no policy reason to limit the liability of Harrison for the injuries suffered by Ballew. A bankruptcy court is not required to "divine what might have happened" had the fraud not occurred. In re Siriani, 967 F.2d 302, 306 (9th Cir. 1992).

Harrison argues that any amount of damages in excess of the original amount of the note operates as a penalty, which is prohibited under Siriani. Id. In Siriani, the court noted that the "creditor is allowed to recover only those damages caused by the fraud and is not entitled to a reward through the imposition of a penalty on the debtor." Id. (citing Jenner v. Hunter (In re Hunter), 771 F.2d 1126, 1128 (8th Cir. 1985)). However, the Supreme Court's holding in Cohen brings earlier Ninth Circuit cases into question with regard to the issue of "penalty" and disapproves certain lower court cases limiting liability. 523

U.S. at 213 (holding all liabilities that arose from fraud were nondischargeable under § 523(a)(2)(A)).

In this case, the amount of damages in excess of the note was a "direct consequence" of Harrison's conduct, as stated by the bankruptcy court. Any interest, penalties, fees, costs, acceleration and default provisions are directly set forth in the terms of the note, which was a note assigned to Kildew by Julie Harrison, the original lender. Section 523 also reflects the policy considerations that "the fresh start is for the 'honest but unfortunate debtor,' not the defrauder." Siriani, 967 F.2d at 306 (citations omitted). Accordingly, the increase in the amount of the judgment does not operate as a penalty on Harrison, and the bankruptcy court's finding of proximate cause was not clearly erroneous.

3. The Bankruptcy Court Did Not Err In Determining That Harrison Was Not Entitled To Offset Of Damages

Harrison contends that he is entitled to an offset of damages for: (1) the period of time that Ballew lived at 6912 Petrie and did not pay the note and mortgage; and (2) the period of time in which Ballew collected rent from roommates while they resided at 6912 Petrie.

The bankruptcy court made the following findings:

> Plaintiff has not claimed nor proven damages associated with any loss of equity as a result of his loss of 6912 Petrie Street to foreclosure. Were he still the owner of the property, he may have been able to show substantial damages when comparing the value of the property with a clean title to that with the boundary defects. And because Plaintiff will recover no damages for such a loss, Defendants' argument is that the Court should reduce any damages award by the amount of payments Plaintiff failed to make on his first and second mortgages

> leading up to the foreclosure misses the mark. Also irrelevant in this analysis is any suggestion by Defendants that damages should be offset because Plaintiff occupied the house for an extended time without paying mortgage payments. Again, any value of Plaintiff's possession was offset, in the Court's view, by the fact that Plaintiff lost the property as a result of Mr. Harrison's conduct.

Mem. Decision at 34-35, Feb. 10, 2006.

The bankruptcy court made no specific finding of value attributed to possession, and the discussion of "any value" with respect to damages was merely speculative. The bankruptcy court indicated that Ballew's damages might have been substantially greater had he not lost 6912 Petrie in foreclosure due to Harrison's conduct. The bankruptcy court was not required to place a pecuniary value upon damages neither pled nor proven, and it did not do so.

Section 553(a) is applicable to setoff in bankruptcy and provides, in relevant part:

> This title does not affect any right of a creditor to offset a mutual debt owing by such creditor to debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case. . . .

11 U.S.C. § 553(a).

The burden to prove setoff rests upon the party asserting the same. In re County of Orange, 183 B.R. 609, 615 (Bankr. C.D. 1995) (citing United States v. Arkinson (In re Cascade Roads), 34 F.3d 756, 763 (9th Cir. 1994)). Mutuality of debt requires that: (1) debts must be in the same right; (2) debts must be between the same individuals; and (3) those same

individuals must stand in the same capacity. Id. (citing In re Visiting Home Serv., Inc., 643 F.2d 1356, 1360 (9th Cir. 1981)).

Section 553 requires mutuality of debt for setoff. Harrison contends, without any authority, that he is entitled to setoff (also known as offset) for the period during which Ballew occupied 6912 Petrie and failed to make payments on the note and the mortgage, specifically, from 2001 through 2003.

First, as the record reflects, Harrison was not the holder of either the first or second deed of trust securing the respective notes. The note securing the second deed of trust was transferred by Julie Harrison, holder of the note, to Kildew in May of 2000. Harrison was merely the seller of 6912 Petrie who collected the full purchase price from Ballew in September of 1999. The bankruptcy court determined that Ballew did all that he could to mitigate the damages and that the damages would have likely been greater based upon loss of equity had Ballew retained the property.

Second, the bankruptcy court correctly determined that there should be no offset awarded to Harrison based on roommate rent (or contribution) collected by (or paid by) Ballew. The bankruptcy court did not err in denying the offset.

CONCLUSION

Based on the foregoing, we AFFIRM.