

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In Re	:	Case No. 95 – 3267 – CH
	:	
CHESTER L. GATLIFF,	:	Chapter 7
	:	
Debtor.	:	

RHINER BROS. PLUMBING CO. INC.;	:	Adv. No. 96 - 96259
THE PLUMBERY INC.;	:	
And	:	
DON WYCOFF HEATING, INC., d/b/a	:	
WYCOFF INDUSTRIES,	:	
	:	
Plaintiffs,	:	
	:	
v.	:	
	:	
CHESTER L. GATLIFF,	:	
	:	
Defendant.	:	

ORDER—COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On April 13, 1998, trial was held on the Plaintiffs' Complaint Objecting to Discharge. Debtor, Chester L. Gatliff, was represented by attorney Scott M. Wood; Creditors, Rhiner Bros. Plumbing Co., Inc., The Plumbery Inc., and Don Wycoff Heating, were represented by attorney Kathryn S. Barnhill. At the conclusion of the trial, the Court took the matter under advisement upon a briefing schedule. Post-trial briefs have been filed and the Court now considers the matter fully submitted.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I). The Court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. Chester L. Gatliff ("Gatliff," "Debtor," or "Defendant") was co-owner, manager, and an officer of Homestead Construction, Inc., which built homes in central Iowa. He and his wife, Mary, are sole shareholders, directors, and officers of the corporation.

2. Homestead Construction is still a corporation, maintains a bank account, but stopped doing construction work in January 1995. Gatliff joined F.Mona Inc. as a partner at that time. Frank Mona, a real estate developer, is the other partner in F.Mona Inc.

3. The three Plaintiffs are subcontractors who sold goods and services to Homestead Construction.

4. Although one Plaintiff is shown to be "Don Wycoff Heating, Inc., d/b/a/ Wycoff Industries," the Court believes the correct spelling to be "Wyckoff" as shown by the exhibits and testimony.

5. Homestead timely paid the bills submitted by the contractors through April 1994.

6. Gatliff was aware that his company was having financial problems in the spring of 1994.

7. In May 1994, Don and Ron Wyckoff, as owners of Don Wyckoff Heating, Inc., d/b/a Wyckoff Industries, put a "stop order" on any future work for Homestead.

8. Gatliff met with Don and Ron Wyckoff at the end of June or the first of July 1994. Gatliff told the Wyckoffs that work in progress would be paid and past due bills caught up as homes closed, and that any future work would be paid directly by the Bank. Gatliff never told the Wyckoffs how serious his financial problems were.

9. After recommencing work for Homestead projects on July 18, 1994, Wyckoff submitted bills directly to Community State Bank.

10. Wyckoff was never paid for any work that was past due at the time of the meeting with Gatliff and was never paid for any work completed and billed for after the meeting with Gatliff. Wyckoff stopped work on Homestead Construction homes for the last time on about August 31, 1994. Other subcontractors who finished the work were paid for their materials and services.

11. Wyckoff is owed \$32,899.00 by Homestead Construction.

12. Rhiner Brothers Plumbing Co., Inc. and The Plumbery Inc., both owned by Carl Rhiner, had done business with Homestead since 1993. They stopped work on Gatliff's projects at the end of June 1994.

13. Gatliff spoke with Carl Rhiner in mid-July 1994. Gatliff told Rhiner that he had financial problems and was looking for a partner. Gatliff told Rhiner that Gatliff would see that Rhiner got paid, that Gatliff did not want Rhiner to put mechanics liens on the properties, and to work with him so that he could pay his back bills. In a later phone call, Gatliff told Rhiner that the Bank would pay his bills. Gatliff never told Rhiner how serious his financial problems were.

14. Gatliff testified that he expected and intended for the Wyckoffs and Rhiner to rely on the promises he made.

15. In a later conversation with Rhiner, Gatliff told Rhiner he was going into business with MGM Builders on building townhouses. Rhiner did work on one building in the project and was paid for the work.

16. Rhiner's businesses resumed work on Gatliff's projects on July 21, 1994. Rhiner sent bills for both Rhiner Brothers Plumbing and The Plumbery directly to Gatliff at Homestead

Construction. Rhiner's businesses were paid by the Bank for some of the work done after the conversations between Gatliff and Carl Rhiner.

17. Rhiner Brothers Plumbing is owed approximately \$11,365.40, exclusive of late charges. The Plumbery is owed \$32,418.29. Of this amount, \$16,297.79 is for work performed before Gatliff's conversations with Rhiner.

18. At the time that Rhiner's businesses resumed work on Homestead's projects, they were owed \$31,447.79. Of that amount, \$15,200.00 was subsequently paid.

19. After the work was resumed, Rhiner billed Homestead for \$45,168.77 in new work, of which \$29,743.27 was paid.

20. Gatliff did not have a bank loan in place at the time he spoke with Plaintiffs. In June or July of 1994, Community State Bank took over Homestead's checking account. After that time, payments to subcontractors from construction loan proceeds had to be approved by the Bank. Gatliff would submit bills to the Bank, which would issue the checks and cause them to be mailed out. On August 29, 1994, the Bank extended a loan to Gatliff for a \$100,000.00 line of credit, secured by a mortgage on Gatliff's personal residence. After that date, some checks issued by the Bank were drawn against that line of credit; no funds were dispersed directly to Gatliff on that line of credit.

21. Plaintiffs were not fully paid for work done on houses after the meetings with Gatliff. Plaintiffs completed some work for Homestead Construction after the sales of the houses were finalized, or closed. Gatliff never told Plaintiffs to submit bills, or estimates, on houses before closings.

22. As home sales closed, Gatliff signed affidavits with the home buyers' lending institutions certifying that all subcontractors and materialmen had been paid in full. After signing the affidavits, Gatliff was paid in full by the buyers of the owner-occupied dwellings.

23. Gatliff was not authorized to sign lien waivers on behalf of the Plaintiff subcontractors.

24. Gatliff did not pay the three Plaintiffs with proceeds received from the buyers and/or their lending institutions as the home sales closed.

25. Homestead Construction, Inc. filed a Chapter 7 bankruptcy in 1995.

26. On October 27, 1995, Chester L. Gatliff filed a Chapter 7 bankruptcy petition. Debtor was granted a general discharge on January 23, 1996.

27. On December 13, 1996, Plaintiffs, Rhiner Bros. Plumbing Co., Inc., The Plumbery, Inc., and Don Wycoff Heating, Inc., d/b/a Wycoff Industries, filed a Complaint Objecting to Debtor's Discharge under 11 U.S.C. § 727 (a)(4)(A), (a)(4)(C), and to the dischargeability of certain debts under 11 U.S.C. § 523 (2)(A), and (4).

28. On July 11, 1997, the Court ordered the dismissal of the complaint as it pertains to violations of 11 U.S.C. § 727 (a)(4)(A) and (C).

29. At trial, in advance of the presentation of evidence, Defendant filed a Motion in Limine, seeking to have certain evidence excluded at trial. The Motion was submitted without ruling and rulings were made at trial regarding the admission of evidence.

30. The Court found Chester Gatliff's testimony to be deceptive, evasive, and less than candid.

DISCUSSION

Chester Gatliff's construction company, Homestead Construction, ran into financial problems in the spring of 1994. Don and Ron Wyckoff's companies stopped work on Gatliff's projects in May 1994. Carl Rhiner's companies stopped work in June 1994. Gatliff met with the Wyckoffs and with Rhiner. He promised them they would be paid for both past and future work if they went back to work on his jobs. Their companies returned to work on Gatliff's projects. Wyckoff was never paid for some of the work done before Gatliff's promises were made; they were never paid for any of the work done after the promises were made. Rhiner was never paid for some of the work done before Gatliff's promises were made; he was never paid for some of the work done after the promises were made. Plaintiffs did not file mechanics' liens against the properties. Plaintiffs object to the dischargeability of debt owed them pursuant to 11 U.S.C. §§ 523 (a)(2)(A) and 523 (a)(4).

Relevant portions of the Code at issue read:

§ 523. Exceptions to discharge.

(a) A discharge under section 727 . . . of this 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;

...

(4) for fraud or defalcation while acting in fiduciary capacity, embezzlement, or larceny.

11 U.S.C. § 523 (a).

The standard of proof under § 523 is a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279, 286-87 (1991). For nondischargeability of a debt under § 523 (a)(2)(A), the creditor must show:

- (1) the debtor made a false representation;
- (2) debtor knew the representation(s) were false at the time;
- (3) the debtor made them with intent and purpose of deceiving the creditor;
- (4) the creditor relied upon the false representation; and
- (5) creditor sustained loss and damages as a proximate result of representations being made.

See In re Ophaug, 827 F.2d 340, 342 n.1 (8th Cir. 1987); See also Matter of Stewart, 91 B.R. 489, 494 (Bankr. S.D.Iowa 1988).

Wyckoff has proven the first element. Gatliff personally met with Don and Ron Wyckoff after their companies stopped work. Gatliff testified that he made two representations to the Wyckoffs: that they would get paid for past work and that the Bank would pay them for new work done.

Rhiner has also proven the first element. Gatliff personally spoke with Carl Rhiner after Rhiner's companies stopped work on Homestead Construction projects. Gatliff promised Rhiner that if he worked with him, by not filing mechanics' liens against the properties, Rhiner would get paid for future work as well as past work.

The circumstances at the time Gatliff made the representations show that the representations were false and that Gatliff knew it. Gatliff had bid jobs too close to cost and little or no profit was being made on the houses under construction. At the time he made the promises, Gatliff did not have financing in place for a line of credit to cover costs not covered by the construction loans. Although invoices from Wyckoff and Rhiner were not being paid at that time, Homestead was paying other subcontractors and suppliers.

Although subjective intent is not easy to ascertain, the Court finds that, at the time he made the false representations, Gatliff intended to defraud Wyckoff and Rhiner. Gatliff made the promises to get Wyckoff and Rhiner to finish the work, which they did. Gatliff led the Plaintiffs to believe that the loan with the Bank was a "done deal," when in fact the line of credit secured by

a mortgage on Gatliff's personal residence was not obtained until the end of August. The exhibits establish that draws were made against construction loans on the various houses that these three Plaintiffs worked on and that proceeds from the sales of these homes were paid to Homestead and deposited in their bank account. Although Homestead received proceeds from the sale of 12 of the 17 homes on which the Plaintiffs are still owed, Gatliff paid Plaintiffs zero (\$0.00) from the funds realized from those 12 homes. Gatliff also did not see that money was escrowed to cover the Plaintiffs' invoices for work done or contracted for but not yet paid at the time the sales closed. Perhaps one of the most telling facts that illustrates Gatliff's intent regarding these three Plaintiffs is how other subcontractors were being treated. After work resumed and these Plaintiffs submitted invoices that were not being paid, other subcontractors were being paid. Even after Plaintiffs stopped working for Homestead completely, the subcontractors that Gatliff hired to finish the work were paid, while Gatliff consistently failed to pay these three subcontractors.

At the time that Rhiner's businesses resumed work on Homestead's projects, they were owed \$31,447.79. Of that amount, \$15,200.00 was subsequently paid. After the work was resumed, Rhiner billed Homestead for \$45,168.77 in new work, of which only \$29,743.27 was paid.

Gatliff is not an unsophisticated businessman. He has run this closely-held corporation since it was incorporated on April 30, 1991. Prior to running his own business, Gatliff worked in the construction industry for Grubb Construction. Since 1995, Gatliff has been a partner in F. Mona Inc. As a construction contractor, Gatliff knew the success of his business was dependent on his success in completing homes that were under construction. He also understood the effect that a mechanic's lien would have on the sale of the property. He made promises to the Wyckoffs

and Rhiner that would induce them to finish the work, with the intent and purpose of deceiving them.

The fourth element, reliance, need not be reasonable, only justifiable. See Field v. Mans, 116 S.Ct. 437 (1995). The standard of justifiable reliance turns on the creditor's qualities and characteristics and the particular circumstances of the case. Id., 116 S.Ct. at 444. Thus, a person may be justified in relying on a factual representation without conducting an investigation, so long as the falsity of the representation would not be patent to him if he used his senses to make a cursory examination. Id. Several courts have found that where a long term relationship exists, a creditor's reliance on his friend's representations is reasonable. See generally, In re Braizblot, 194 B.R. 14, 20 (Bankr. E.D.N.Y. 1996). The Plaintiffs in this case had a long-term business relationship with Bud Gatliff that started when he worked for Grubb Construction and continued when he established Homestead Construction. Homestead's payment history was good, there had been no problems and bills had been paid timely. When payments became erratic in mid-1994, they saw the red flags and pulled their employees off the jobsites. When Gatliff promised they would be paid if they resumed work and did not file mechanics' liens, Plaintiffs believed him. They wanted Gatliff to succeed personally. Plaintiffs' reliance on the representations made by Gatliff was reasonable and justifiable.

Absent Gatliff's misrepresentations, the Plaintiffs would not have provided property or services or foregone their right to file mechanics' liens against the real property. Goods and services provided after Gatliff's promises were made were a direct result of the representations that the Plaintiffs would be paid for future work. The Court finds that Plaintiffs' failure to timely file mechanics liens for work done before the misrepresentations were made was also a proximate result of Gatliff's misrepresentations. The Court finds that foregoing a legal right

is in the nature of "property" for purposes of 11 U.S.C. § 523 (a)(2) and that Gatliff obtained such property by fraud. Therefore, § 523 (a)(2)(A) applies to the debt owed these Plaintiffs for work done even before the misrepresentations were made, in addition to work done after the misrepresentations were made.

At the time of the misrepresentations, the Plaintiffs could have filed mechanics liens against the real properties involved; as a result of their reliance on the representations, their rights under the state statutes governing mechanics liens have lapsed. As a result, their damages resulting from their reliance on the misrepresentations is the total amount of debt owed them both before and after the misrepresentations were made. See generally Cohen v. DeLaCruz, 118 S.Ct. 1212, 1216-1217 (1998).

Gatliff argues that he should not be held personally liable because the representations were made on behalf of the corporation. Several Circuit Courts, including the Eighth Circuit, have found that the debtor need not personally receive the money, property, or services obtained by fraud for it to be nondischargeable under § 523 (a)(2)(A). See In re Dallam, 850 F.2d 446 (8th Cir. 1988); In re Bilzerian, 100 F.3d 886 (11th Cir. 1996); In re Ledford, 970 F.2d 1556 (6th Cir. 1992); In re Luce, 960 F.2d 1277 (5th Cir. 1992); In re Ashley, 903 F.2d 599 (9th Cir. 1990). As the Eighth Circuit noted, "[t]he fact that [debtor's] fraud obtained the benefit for [his] closely held corporation rather than [himself] directly does not alter [his] liability under 11 U.S.C. § 523 (a)(2)." Dallam, 850 F.2d at 449 n.2.

The evidence shows that Plaintiffs have proven each of the required elements under 11 U.S.C. § 523 (a)(2)(A); the debt is therefor nondischargeable.

Because the Court has determined that the debt owed both Plaintiffs is nondischargeable pursuant to § 523 (a)(2)(A), nondischargeability under § 523 (a)(4) need not be determined.

ORDER

IT IS THEREFORE ORDERED that the debts owed Rhiner Brothers Plumbing Co. Inc., The Plumbery Inc., and Don Wyckoff Heating, Inc., d/b/a Wyckoff Industries are nondischargeable pursuant to 11 U.S.C. § 523 (a)(2)(A).

Dated this _____ day of October, 1998.

RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT