UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In Re:	:	**Case No. 02-02894-CH**
	:	
RODNEY R. BROWN and CINDY E. BROWN,	:	**Chapter 7**
	:	
Debtors.	:	
- -	:	
JAMES SUMPTER and KATHY SUMPTER,	:	**Adv. No. 02-20122**
	:	
Plaintiffs,	:	
	:	
v.	:	
	:	
RODNEY R. BROWN,	:	
	:	
Defendant.	:	

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ORDER— COMPLAINT TO DETERMINE THE DISCHARGEABILITY OF A DEBT AND OBJECTION TO DISCHARGE

Trial was held in the above captioned proceeding on April 7, 2003. Peter W. Berger represented plaintiffs James and Catherine Sumpter. James W. Cleverley, Jr. represented defendant Rodney R. Brown. At the conclusion of the trial, the court took the matter under advisement on a briefing schedule. Post-trial briefs have been received, and the court considers the matter fully submitted.

The court has jurisdiction of this matter pursuant to 28 U.S.C. §§ 157(b)(1) & 1334 and order of the United States District Court for the Southern District of Iowa. This is a core proceeding pursuant to 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. On May 28, 2002, Rodney Ray Brown and Cindy Ellen Brown filed a voluntary petition in the United States District Court for the Southern District of Iowa under chapter 7 of title 11, the Bankruptcy Code. (Cindy Brown is not named as a defendant in this adversary proceeding; accordingly all references to Brown, unless otherwise specified, refer only to Rodney Brown).

2. On Schedule F – Creditors Holding Unsecured Nonpriority Claims, Brown scheduled James and Catherine Sumpter as creditors holding a claim for $100,000.00 based on a "possible judgment." On the statement of financial affairs, Brown identified that he was a party to a suit for a breach of contract with the Sumpters and scheduled its status as pending. (When testifying, Mrs. Sumpter identified herself as Catherine).

4. Prior to filing for bankruptcy protection, Brown was engaged in the construction industry for a number of years. He did roofing, framing, siding, cabinetry, and erected farm structures. At one time in the mid-1990s, he, his brother, and a third person formed a partnership that built residential structures. The partnership dissolved, and Brown continued in the construction industry individually doing business as Rod Brown Construction.

5. On September 3, 1999, the Sumpters approached Brown about doing construction work on a home for them in a rural area near Baxter, Iowa. James Sumpter approached Brown at his home in Reasonor, Iowa. A friend, who was acquainted with

Brown's father and had business dealings with his father, accompanied Sumpter to the meeting. The Sumpters wanted to build a "berm house" in the country to use as their retirement residence, and the friend identified Brown as a contractor who could do the job. After some discussion, the parties entered into an oral contract whereby Brown agreed to the framing, roofing, and install doors and windows for $42,203.00.

6. At the meeting, Brown represented to Sumpter that he had a reputation in the community for doing quality work and that he built to meet the building code standards of the city of Newton, Iowa. He also represented that he could do the required work satisfactorily for the estimated amount.

7. Brown did not disclose that his construction business was having financial difficulty and that he was in arrears in his account at McKlveen Lumber Company (McKlveen) in Newton, Iowa. Brown did not disclose that he owed McKlveen for material used in other projects. Brown did not disclose that he maintained a single account at the lumberyard for all his purchases, and not separate accounts for each project. However, when he purchased materials from McKlveen, he identified where the materials were to be used. McKlveen applied the funds paid by Brown to his account on a first-in-first-out basis. McKlveen applied the payments to Brown's existing debt and considered the materials used in the Sumpters' house as purchased on credit. Brown agreed to this procedure.

8. On September 3, 1999, Sumpters wrote a check to Brown for $20,000.00. The funds were to be used as a down payment on their home for costs and materials. Brown cashed the check on September 7, 1999.

9. Brown did not commence work on the Sumpters' home until November 1999. A close friend of Brown died from injuries sustained from an accident on a job where he and Brown were working. Brown held a funeral reception at his home in Reasonor, Iowa. He testified that the Sumpters came to the reception, and told him not to worry about their house; he should take all the time he needed to grieve. The Sumpters dispute the assertion that they told him delay the construction of the house and take "all the time he needed."

10. On November 30, 1999, the Sumpters wrote another check to Rod Brown construction in the amount of $10,000.00. Brown cashed the check on December 1, 1999.

11. In December 1999, the parties' relationship began to deteriorate. The Sumpters were concerned with the lack of progress on the house. James Sumpter testified that Brown was increasingly absent from the jobsite and did not respond to telephone calls. Further, the Sumpters discovered deficiencies in the quality of Brown's work product. So much so, that James contacted Dennis Babcock, the manager at McKlveen's lumberyard in Newton. Babcock reviewed the jobsite and identified the use of substandard materials and substandard work. Catherine testified that Babcock classified the mistakes as major. According to James, Babcock advised him not to allow Brown back on the job and suggested that he sue him.

12. Brown testified that James Sumpter approached him in late November with concerns about his ability to pay the remaining amount due. He asked if final payment could wait upon the sale of their home in Newton. Brown testified that he

agreed to reduce the amount of time he spent on the job in order to give the Sumpters additional time to acquire the final amount owed. Brown conceded certain mistakes made in the construction, but stated that he planned to go back and correct the mistakes. However, he testified that the Sumpters ordered him off the job and threatened to have him arrested for trespass if he returned. Brown admitted that he did not receive this information directly from the Sumpters.

13. The evidence presented showed that Brown used poor quality, substandard lumber in framing the structure. Certain two x fours in the interior wall were of inferior grade, narrowed in places or tapered at the ends. Lumber was split, some boards up to one third of its length and as much as two and a half feet. The damaged lumber was of particular concern in load bearing situations. Certain studs were cut too short, and rather than being replaced with one of the proper length, a short piece of lumber was "scabbed" on to the short stud. At least one stud was made by nailing two short boards together with a third piece of lumber scabbed over the junction. Gaps appear between the underside of the roof trusses and the supporting wall, and there is a significant dip in the roof trusses. Trimmer or jack studs were not installed under window frames in load bearing walls. Certain sections of the frame showed improper nailing of the studs, and studs were not installed in the corners for the fastening of sheetrock. At least one door opening was so far out of square as to prevent the door from opening and closing properly. The rows of shingles were not straight with the roofline of the house and numerous nail heads were visible. Of even more concern was the large bulge where the shingles did not lay flat on the roof. Some of the roof cap shingles were cracked and

would require replacement. In sum, the evidence showed that the quality of work was so poor that it needed to be redone.

14. The Sumpters made numerous calls to Brown in an attempt to get him to return to the job and correct the mistakes. Brown did not return their calls. Instead, he contacted an attorney to help resolve the dispute.

15. In a letter dated January 19, 2000, attorney James W. Cleverley (hereinafter Cleverly) contacted the Sumpters regarding the construction of their home. The letter stated that Brown has been told that he is not allowed back on the property. It expressed Brown's desire to perform the contract and avoid litigation. Finally, it indicates that Brown is owed an additional $15,513.47 upon completion of the project.

16. On January 27, 2000, the parties met at McKlveen's business office in an attempt to resolve the dispute. Babcock set up the meeting purportedly to mediate and facilitate the resolution of the dispute. Brown testified that an agreement was reached at the meeting whereby he would complete the project, and the Sumpters would make a final payment directly to McKlveen. Both Catherine and James Sumpter deny that any agreement was reached.

17. In a letter dated February 14, 2000, Cleverley set forth an offer by Brown to complete the project for the sum of $12,203.00 with such payment to be made payable to McKlveen.

18. On July 17, 2000, the Sumpters filed an incident report with the Jasper County Sheriff alleging fraud on the part of Brown in connection with the construction of their home.

19. On September 25, 2000, the Sumpters filed a petition in the Iowa District Court for Jasper County against Brown alleging breach of contract.

20. On February 25, 2001, McKlveen placed a mechanics lien on the Sumpter property for materials that it supplied to Brown for the construction of the house.

21. On February 14, 2002, McKlveen filed a petition in the Iowa District Court for Jasper County to foreclose on the mechanics lien.

DISCUSSION

James and Catherine Sumpter commenced this adversary proceeding to determine the dischargeability of a debt arising in connection with the construction contract. The Sumpters allege that Rod Brown represented he would do framing, roofing, and install doors and windows for their home for $42,203.00. They further allege that he represented that he was knowledgeable and skilled in the construction industry and would would do quality work that would be suitable to be finished by other subcontractors. The Sumpters contend that Brown failed to complete the work in a timely manner; intentionally cut corners to increase his profit; and intentionally did such poor work that much of the construction needed to be redone. The Sumpters further contend that Brown failed to disclose his financial difficulties, and applied their payments to materials used in other homes, thereby resulting in a mechanics lien being placed on their home by a material supplier. The Sumpters argue that their claim should be excepted from discharge pursuant to 11 U.S.C. §§ 523(a)(2)(A) & (a)(4). For the following reasons, the court agrees that their debt should not be discharged.

Dischargeability Under 11 U.S.C. § 523(a)(2)(A)

The Bankruptcy Code provides that discharge under section 727 does not discharge an individual from certain debts. 11 U.S.C. § 523. Section 523(a)(2) provides in relevant part that a debtor is not discharged from any debt:

> (2) for money, property, services, or an extension, renewal, or other 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;

11 U.S.C. § 523(a)(2)(A).

The standard of proof under § 523 is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286-287 (1991). It "is the evidence which, when weighed with that opposed to it, has more convincing force and is more probably true and accurate." Smith v. United States, 557 F. Supp. 42, 51 (W.D. Ark. 1982) aff'd, 726 F.2d 428 (8th Cir.1984). The party with the burden of proof must provide evidence to prove his or her position is reasonably probable, not merely possible. Sherman v. Lawless, 298 F.2d 899, 902 (8th Cir. 1962). If the proven facts equally support each party's position, "the judgment must go against the party upon whom rests the burden of proof." Id.

The Eighth Circuit has adopted a five-part test to determine whether a debt will be excepted from discharge under § 523(a)(2)(A). The court asks whether: (1) the debtor made false representations; (2) the debtor knew these representations were false at the time they were made; (3) the debtor made these representations 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. Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987) as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995).[1]

The plaintiff must prove each element of his § 523 (a)(2)(A) claim or the debt is not excepted from discharge. Id. Because direct proof of debtor's state of mind is "nearly impossible to obtain," the requisite intent may be inferred from circumstantial evidence. In re Van Horne, 823 F.2d at 1287.

"The first, second, and third elements can be considered together by asking whether the debtor made false representations knowingly and with the intent to deceive the creditor." AT&T Universal Card Services v. Broerman (In re Broerman), No. 97-2569-CH, Adv. No. 97-97203 at 5 (Bankr. S.D. Iowa Jan. 19, 1999) (Judge Hill decision book # 313).

At the outset, the court notes that it is not unusual for there to be confusion and differences of memory between the parties about statements that have been made, particularly when the contract is essentially a handshake agreement. Memory fades over time and perceptions alter when disputes arise. Likewise, it is not unusual in such situations for false statements to be made to support one party's position. In such situations the court's role of finder of fact and credibility becomes more pronounced.

In this case, viewing the demeanor of the witnesses in open court and listening to their testimony, the court finds James and Catherine Sumpter to be credible witnesses.

[1] In Van Horne, the Eighth Circuit originally held that the plaintiff must prove that his or her reliance was reasonable, however, the United States Supreme Court in Fields determined that the proper standard under 11 USC § 523(a)(2)(A) is "justifiable reliance." Additionally, Van Horne held that the plaintiff had the burden of proving the debtor's deceit by clear and convincing evidence. In Grogan, the United States Supreme Court held the proper standard to be by the preponderance of the evidence. The balance of Van Horne remains good law.

The court finds their recollection and version of events to be the more accurate. When their testimony directly conflicts with that of other witnesses, the court finds their statements to be more a more accurate recitation of events. Accordingly, the court gives more weight to their testimony than it does to that of Brown or Babcock.

Turning to the facts of the case, the court finds that Brown knowingly made false representations and intentionally deceived the Sumpters into entering into the construction contract and making two payments totaling $30,000.00. The court does not believe that the Sumpters begged Brown to do the work or that he was doing them a favor by taking the job. By his own admission, Brown was a late pay at McKlveen's, and his account was past due in September 1999. Brown further admits that he took the initial $20,000.00, and used some of those funds to pay on his account. Accordingly, the court finds that Brown's primary motivation was to acquire the initial payment from the Sumpters.

Further, the court finds that Brown did not intend to construct a quality home, rather his intention was to sacrifice workmanship in order to maximize his profit. In so doing, Brown was willing and intended to accept inferior materials from McKlveen and incorporate them into the construction.

The court bases this finding on the evidence of the substandard materials and workmanship that Brown employed in constructing the Sumpters' home. The construction is riddled with split lumber, short studs, missing studs, gaps, and scabbed joints. Possibly the most egregious instance of faulty construction is the roof. The trusses are improperly placed with a resulting dip, cap shingles are cracked, and nail

heads are visible in the shingles. There is a large, visible bulge where the shingles have lifted. Further, the shingles do not follow the line of the house. While not as significant in other structures, this cosmetic deficiency is readily apparent from the uphill side of the berm home.

When presented with this evidence, Brown acknowledged the deficiencies. He admitted that it was substandard work and needed to be corrected. He then explained how each problem could be fixed and his intention to go back and do so.

However, the court is reminded of the old adage that it is cheaper to do a job right the first time, than it is to go back and try to fix it. The court questions why Brown did not do the work right the first time if Brown knew that these were not proper construction methods. The court concludes he intended to employ substandard methods and use substandard materials in order to maximize his profit to the detriment of the Sumpters.

The court's finding of misrepresentation is bolstered by the following facts. Brown did not start the project until November even though he received the first payment in September. The court discounts Brown's testimony that the Sumpters told him to take as much time as he needed after the accidental death of his friend. The court does not doubt that the Sumpters expressed sympathy and compassion, but it does not believe that they gave Brown complete discretion to indefinitely postpone the beginning of the construction. All the parties have lived in Iowa for a number of years and are familiar with the uncertainty of the weather going into the winter months. Consequently, getting the roof on the house and enclosing the structure would be of primary concern.

Further, Brown was frequently absent from the jobsite, and did not respond to numerous calls to his residence. The Sumpters resorted to asking Babcock to take a look at the construction. Babcock confirmed that the construction was substandard. The court believes that Babcock made an additional comment to the Sumpters to the effect Brown should be held accountable for his shoddy workmanship. The court does not believe that the Sumpters authorized Babcock to order Brown not to return. To the contrary, the court finds that the Sumpters actively tried to get Brown to return and satisfactorily complete the job that he contracted to do.

Finally, it is well-settled that the failure of a debtor to disclose a material fact can serve as the basis of an action under 11 U.S.C. § 523(a)(2)(A). In re Van Horne, 823 F.2d at 1288. The debtor does not need to "bare his soul," but "the creditor has the right to know those facts touching upon the essence of the transaction." Id.

In this case, the Sumpters believed that the funds advanced to Brown would be used to pay, at least in part, for materials used in the construction of their house. Brown did not disclose to them his open account agreement with McKlveen, and the fact that he was behind in that account. He did not disclose to them that because of that arrearage, their house could be subject to a mechanic's lien even if they paid him in full.

In Iowa, normally cash advanced as a down payment pursuant to a construction contract is an outright transfer of title and possession of the funds and not held in trust for a specific purpose absent contract provisions to the contrary. State v. Galbreath, 525 N.W.2d 424, 426-27 (Iowa 1994); Caslavka, 531 N.W.2d at 104. Further, "[i]t is not uncommon for a contractor who has entered into a construction contract to default in the

performance of that contract. In such a situation, it is not uncommon for the contractor to have left unpaid those who have furnished labor and materials for the project which was the subject matter of the contract." Randall v. Colby, 190 F. Supp. 319, 327 (N.D. Iowa 1961). Such a situation gives rise to a breach of contract; but breach of contract does not necessarily equate to fraud.

However, in this case, the court finds that had Brown disclosed the nature of his agreement with McKlveen; disclosed that he owed a substantial amount on his account; and disclosed that even after they paid the contract price their property would be subject to a mechanic's lien; the Sumpters would not have entered into the contract, or they would have taken steps to protect themselves. As it was, Brown projected that he was a competent, and successful contractor, and they had no reason to believe otherwise. Therefore, the court finds that Brown failed to disclose material facts that went to the essence of the contract, and such failure to disclose constitutes misrepresentation.

Upon showing that Brown knowingly made false representations with the intention to deceive, the Sumpters must then show they justifiably relied on the representations. Courts have recognized at least three levels of reliance in the context of § 523(a)(2). The lowest standard is actual reliance. This is mere reliance or reliance in fact. Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 343 (8th Cir. 1987). Justifiable reliance is a higher standard. See Field, 516 U.S. at 66. The individual 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. at 71. Reasonable reliance is a higher standard still.

Id. at 76. The individual must exercise the care of a reasonably prudent person under the circumstances. Id. at 77, 80, 81.

The court also finds that the Sumpters justifiably relied on Brown's representations. James Sumpter came to Brown through a friend that was acquainted with Brown's father. Brown also knew the friend whom he called Cody. Essentially, Sumpter came to Brown upon a reference from a mutual friend who recommended Brown as someone he could trust to do a good job. Brown testified that this was the normal way that he got projects, as he did no other advertising.

Finally, the court finds that the Sumpters sustained injuries as a proximate result of the representations. James Sumpter testified that he had to hire another contractor to correct the substandard construction and finish the project. The new contractor removed and discarded all the interior two x fours and damaged lumber. He also testified that the roof needed to be torn off and replaced. The Sumpters have not had the roof repaired yet because they do not have the estimated $10,000.00 required to do the work. Further, McKlveen placed a mechanic's lien on the property and commenced a foreclosure action against the property. The Sumpters have been forced to defend against this action which was scheduled for hearing on July 23, 2003.

For all the foregoing reasons, the court finds that the Sumpters have carried their burden by a preponderance of the evidence. Accordingly, their claim will be excepted from discharge.

Dischargeability Under 11 U.S.C. § 523(a)(6)

Even if the court found that Brown did not knowingly make misrepresentations to the Sumpters, the court would hold that he willfully and maliciously injured their property. As such, the debt would be excepted from discharge pursuant to 11 U.S.C. § 523(a)(6).

Under § 523(a)(6), the elements of willfulness and malice are analyzed separately. Barclays American/Business Credit v. Long (In re Long), 774 F.2d 875, 880 (8th Cir. 1985). "Willful" means intentional or deliberate. Id. "Malice" must apply to a heightened level of culpability that goes beyond recklessness if it is to have a meaning independent of willful. Johnson v. Miera (In re Miera), 926 F.2d 741, 743 (8th Cir. 1991). The Eighth Circuit has defined willful as "headstrong and knowing" conduct and "malicious" as conduct "targeted at the creditor . . . at least in the sense that the conduct is certain or almost certain to cause …harm." Id. at 743-44. The act must be done with the actual intent to cause injury to the creditor. Kawaauhau v. Geiger, 523 U.S. 57, 61-64 (1998).

In this case, the court finds that Brown willfully caused injury to the Sumpters. He intentionally used substandard materials in constructing the frame and the roof of their home. He intentionally cut corners and employed methods that he knew would produce a structure that did not meet Newton's construction code regulations or the expectations of the Sumpters. Brown admitted to the use of improper construction techniques and inferior lumber when examined. Further, Brown refused to return to the job claiming that he had been ordered not to return. Brown's actions are in no way mitigated by his assertion that he intended to go back and fix the errors. The court has previously announced its skepticism as to this claim.

The court also finds that Brown's conduct was certain to harm the Sumpters. The structure was riddled with poor construction and materials. Brown knew that the materials and construction were substandard and that the problems should be corrected before the house could be finished. He also admitted that the bulge in the shingles would have to be corrected.

Such injury was borne out when the Sumpters had to hire a new contractor to correct the poor work. The new contractor had to replace all the inferior quality lumber and replace it with new. The roof still needs to be replaced, but has not been due to lack of funds.

Accordingly, the court finds that the intentional actions of Brown resulted in an inferior structure that necessitated major rehabilitation to be suitable for occupancy. The Sumpters were injured by the loss of time, loss of enjoyment, and more substantially, loss of funds that they necessarily had to pay to have the house fixed.

The court also finds that the Sumpters were injured when McKlveen placed a mechanic's lien on the house and proceeded to foreclose. The court notes that Babcock testified that the lien on the Sumpter house was the first time that he had placed a mechanic's lien on a property in his ten years as manager. He admitted that he placed the lien in order to pressure the Sumpters not to maintain this action, and even though Brown had reaffirmed his debt to McKlveen and was paying down the balance owed on materials, Babcock would not release the lien.

In conclusion, the court acknowledges that numerous cases exist where contractors have discharged debts incurred through shoddy construction of homes. See e.g., Gadtke v. Bren (In re Bren), 284 B.R. 681 (Bankr. D. Minn 2002); Vaughn v. Quinn (In re Quinn),

180 B.R. 550 (Bankr. E.D. Mo. 1995); Rezin v. Barr (In re Barr), 194 B.R. 1009 (Bankr. N.D. Ill. 1996). The common thread in each of these cases is that the debtor contractor acted negligently in the construction and without the intent to deceive or injury. In short, the courts found the debtor to be incompetent, but not intentionally so. However, when convinced that contractors act in a deceptive manner with the intent to enrich themselves at the expense of the homebuyer, courts will readily determine the debt to be nondischargeable. See e.g., Kadlecek v. Ferguson (In re Ferguson), 222 B.R. 576 (Bankr. N.D. Ill. 1998); Shannon v. Russell (In re Russell), 203 B.R. 303 (Bankr. S.D. Cal. 1996).

For all the foregoing reasons, the court finds that the Sumpters have carried their burden by a preponderance of the evidence. Therefore, their claim against Brown will be excepted from discharge.

ORDER

IT IS THEREFORE ORDERED that Rodney R. Brown's debt to James and Catherine Sumpter is not discharged.

Dated: _____, 2004.

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