

In the United States Bankruptcy Court

for the Northern District of Iowa

Charles D. Glew

Sheryl A. Glew

Debtor(s).

Bankruptcy No. 97-01387C

Chapter 7

Jomo Investments Inc.

Plaintiff(s)

vs.

Charles D. Glew

Sheryl A. Glew

Defendant(s)

Adversary No. 97-9158-C

RULING

On July 21, 1998, the above-captioned matter came on for trial pursuant to assignment. Plaintiff Jomo Investments, Inc. was represented by Attorney Keith Stapleton. Debtors/Defendants Charles and Sheryl Glew were represented by Attorney Richard Hansen. After the presentation of evidence and argument, the Court took the matter under advisement. The parties have filed briefs and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

Jomo Investments asserts its claim is excepted from discharge under §523(a)(2)(A) as arising from Debtors' fraudulent representations. It argues that Debtor Sheryl Glew agreed to apply Jomo's payment of \$40,000 on their construction contract to balances due to a materials supplier and to preexisting debt to Midwest Heating & Plumbing Co., a separate corporation related to Jomo. Debtors deny making any misrepresentations and argue Plaintiff has not been damaged.

FINDINGS OF FACT

Plaintiff Jomo Investments, Inc. is wholly owned by its president, William J. Skogman. Mr. Skogman and Debtors were friends and had a periodic business relationship. Debtors were the sole owners of a corporation named Glew Construction Co. In May, 1995, Debtors agreed to construct a portion of a building at 1100 Industrial Park in Hiawatha, Iowa, for Jomo. The parties dispute the exact contract price. The exact price was never formalized. To a large degree, the parties operated under an unsigned proposal prepared by Glew Construction Co. on May 10, 1995. From the evidence presented at trial, it is fair to conclude that the total contract price, after adjustments for add-ons and changes, was at least \$63,873.43.

On October 25, 1995, before completion of the work, Debtors sent an invoice to Jomo Investments in the amount of \$63,873.43. On November 1, Debtor Sheryl Glew visited William Skogman at the shared offices of Jomo Investments and his related company Midwest Plumbing & Heating Co. Mrs. Glew testified she met with Mr. Skogman to discuss payments due by Debtors to Midwest Plumbing arising from other construction projects from 1994. She had recently become aware of outstanding invoices from Midwest Plumbing totaling approximately \$45,000 from prior projects.

These invoices were unanticipated as Mrs. Glew testified she thought all plumbing costs had been paid. This balance due had a negative effect on Debtors' construction company's cash flow as well as profit margin on past projects.

Mrs. Glew testified that the invoice from Glew Construction on the Jomo building also came up as part of her conversation with Mr. Skogman. At the time, most of Debtors' work on the building was completed.

Mr. Skogman testified that Mrs. Glew informed him that Glew Construction Co. lacked funds to pay ReVosWel, a materials supplier for the Industrial Park project. He believed that ReVosWel refused to supply further building materials to Debtors to complete the Jomo building until it received payment for materials already supplied. Mrs. Glew testified that, at that time, however, no further supplies from ReVosWel were required for the Jomo building.

Mr. Skogman testified that Jomo Investments issued a \$40,000 check to Debtors on November 1, 1995 on the condition that the money be used exclusively to pay ReVosWel in full for supplies delivered for the building at 1100 Industrial Park. Any remaining balance was to be paid to Midwest Plumbing for invoices from the 1994 projects. Jomo Investments alleges Debtor Sheryl Glew misrepresented that she would use the \$40,000 check from Jomo Investments as Mr. Skogman directed and instead converted the money to some other use.

Mrs. Glew testified that she did not understand that the money was given on any condition. During the November 1 conversation with Mr. Skogman, Mrs. Glew became upset and left to go to the restroom. When she came back, Mr. Skogman presented her with the check for \$40,000, which Jomo's bookkeeper, Vicki Stebral, had prepared. Mr. Skogman and Mrs. Glew discussed using some of the funds to pay ReVosWel and Midwest Plumbing. Mrs. Glew testified that some discussion occurred concerning payment of the Midwest Plumbing account. However, she testified that no understanding was reached as to how the check was to be distributed. Mr. Skogman, on the other hand, testified that he issued the \$40,000 check only with the stated conditions. Ms. Stebral did not participate in the November 1 conversation between Mr. Skogman and Mrs. Glew. She testified, however, that she heard Mrs. Glew state she would pay ReVosWel and Midwest Plumbing, after she thanked Mr. Skogman for the \$40,000 check.

Debtors claim the \$40,000 check was not issued with any conditions, but rather the money was to be applied against the contract price for the 1100 Industrial Park project. At the time the check was issued, Jomo Investments had received an invoice from Glew Construction Co. for \$63,873.43 based upon the contract. Plaintiff does not deny that this account was due and payable at that time. Soon after Jomo's check was deposited in Debtors business checking account, Debtors made payments to ReVosWel of \$17,054.60 and \$4,898.51 and to Midwest Plumbing of \$1,800. The payments to ReVosWel, however, were credited against invoices for projects other than the Jomo building.

Jomo Investments claims that it suffered damages from ReVosWel's filing of two mechanic's liens. ReVosWel filed its first mechanic's lien against Jomo Investments on February 16, 1996, in the sum of \$29,634.68 plus interest. Jomo received service of notice of this mechanic's lien on September 18, 1996. This was for materials supplied from August 25 to October 4, 1995. ReVosWel filed a second mechanic's lien against Jomo Investments on April 25, 1996, in the sum of \$28.11 plus interest, for materials supplied through February 23, 1996. It is evident from the mechanic's liens that essentially all materials for the 1100 Industrial Park project had already been supplied by ReVosWel prior to the parties' November 1, 1995 conversation.

Debtors argue that Jomo Investments has suffered no damages because the first mechanic's lien was filed by ReVosWel after the lapse of ninety days from the last date materials were supplied. An action on the enforceability of this mechanic's lien is presently pending in the Linn County District Court. Debtors argue that under Iowa Code section 572.11, a mechanic's lien is enforceable only to the extent that the owner owes money to the general contractor as of the date of the filing of the lien. Thus, Debtors argue that because Plaintiff need only pay ReVosWel what it legally owes Glew Construction Co. for services performed under the contract, Plaintiff has suffered no damages.

Jomo also argues it suffered damages from Glew Construction Co.'s failure to complete work required under the contract. Jomo Investments expended approximately \$13,000 to employ other persons to complete the project. Debtors assert they completed their work on the Jomo building as agreed. Debtor Charles Glew testified that they built the building in accordance with the specs. A vapor barrier and a fire wall were required by city inspectors. These, however, were not part of the specs Debtors used to bid the job.

CONCLUSIONS OF LAW

Jomo bears the burden to prove the elements of its claim under 11 U.S.C. §523 by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 290 (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) (citations omitted).

Section 523(a)(2)(A) states:

(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 -

(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).

A plaintiff proceeding under §523(a)(2)(A) must prove the common law elements of fraud, which include: (1) the debtor made false 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. See Van Horne, 823 F.2d at 1287; Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that "§523(a)(2)(A) requires justifiable, but not reasonable, reliance"). In a similar case, a court held that a prima facie case requires proof that the debtor misrepresented that the creditor's payments on a building contract would go to pay subcontractors and materials suppliers, while intending that the money be used for personal expenses or start-up expenses for other projects. In re Johannessen, 76 F.3d 347, 350 (11th Cir. 1996) (denying motion to dismiss for failure to state a claim).

Jomo must first establish that Debtors made a false representation. There is legal authority for the proposition that a debtor who acquires money with the condition that it be used for restricted purposes and who has no intention to abide by such restriction creates a misrepresentation upon which the debt may be declared nondischargeable. In re Gans, 75 B.R. 474, 493 (Bankr. S.D.N.Y. 1987). The false representation must relate to a present or past fact. In re Shea, 221 B.R. 491, 496 (Bankr. D. Minn. 1998). A promise to make a certain payment is not ordinarily a false representation under §523(a)(2)(A), unless the promise is made without the present intention to follow through. Id. at 497. A debtor must make the promise knowing it to be false to support a claim of nondischargeability. In re Lund, 202 B.R. 127, 131 (B.A.P. 9th Cir. 1996).

A bare promise to be fulfilled in the future which is not carried out does not render a debt nondischargeable. In re Cox, 161 B.R. 667, 670 (Bankr. W.D. Ark. 1993). Good faith promises are not misrepresentations of fact. Id. In In re Brookshire, 17 B.R. 308, 309 (Bankr. N.D. Ga. 1982), a creditor paid the debtor for labor and materials. The debtor paid the materials supplier, without specifying a particular project, and the supplier credited the debtor's general account. Id. The court held that although this may have been negligence or sloppy business practice, the debtor did not act deliberately to deceive or harm the creditor. Id. at 311.

The Court will first discuss Plaintiff's claim against Defendant Charles Glew. The dischargeability complaint is based solely on an alleged misrepresentation made by Sheryl Glew to William Skogman on November 1, 1995. There is no allegation made that Charles Glew made any representations directly upon which this dischargeability complaint is based. Rather, it is the position of Plaintiff that the misrepresentation, if any, is imputed to Mr. Glew because of the marital relationship of the parties as well as their business relationship with Glew Construction Co. This Court must, therefore, determine whether any alleged misrepresentations made by Sheryl Glew can be imputed to Charles Glew. To impute responsibility under principles of agency law, Sheryl Glew would have to be considered an agent not only of Glew Construction Co. but also her husband Charles Glew. Proof of an agent's fraud does not justify denial of discharge

of a debtor unless there is proof supporting the inference that the debtor knew or should have known of the fraud. In re Walker, 726 F.2d 452, 453 (8th Cir. 1984). In determining whether such an inference is supportable, the Court must look at the extent of Debtors' involvement in the relationship and the exact nature of that involvement. Id.

This Court considered a similar issue in In re Anderson, 29 B.R. 184 (Bankr. N.D. Iowa 1983). The question was whether a partner's intent to deceive can be imputed on the "innocent" partner/debtor. Id. at 190. The Court noted that the Code's policy of discharging honest debtors would be negated by imputing the deceptive intent of one partner to an honest, innocent partner/debtor. Id. at 191. The court considered whether the debtor had seen the financial statement and whether the errors were such that he knew or should have known of the falsity. Id. It held that, though the debtor had seen the financial statement, he was not in the position to know it was materially false and thus did not have the requisite intent to deceive under §523(a)(2)(B). Id.

Similar reasoning was applied more recently in other jurisdictions to find that a wife, unfamiliar with the business affairs or the specific transaction, did not have the intent to deceive based on her husband's false financial statement. In re Boice, 149 B.R. 40, 48 (Bankr. S.D.N.Y. 1992) (finding wife/debtor had no intent to deceive where husband had falsely stated they owned their home; wife had only signed the statement after it was substantially completed by her husband); In re Rental Journal, Inc., 111 B.R. 1012, 1016 (Bankr. S.D. Fla. 1989) (holding that wife/debtor who did not sign the financial statement or negotiate the loans did not have intent to deceive; she was a housewife unfamiliar with the business affairs and was only involved because she had signed a guaranty). In Re Johnson (The First Nat'l. Bank of Waverly v. Johnson), No. 95-60071KW, Adv. No. 95-6074KW, slip op at 2 (Bankr. N.D. Iowa, Feb. 12, 1996).

Here, Plaintiff asks the Court to impute any alleged misrepresentation by Sheryl Glew to her husband, Charles Glew. It is clear from the record that, in addition to being husband and wife, Mr. & Mrs. Glew were closely involved in the family business (Glew Construction Co.). It is fair to conclude that both Debtors understood the workings of the business relationship and were intimately involved in the day-to-day operation of the business. However, such a finding does not, in and of itself, support the conclusion that the misrepresentation of one party should be imputed to the other. The facts of this case compel a contrary conclusion. The specific alleged misrepresentation made by Sheryl Glew to William Skogman was that she promised to commit a portion of the \$40,000 check to ReVosWel for that part of the debt owed by Glew Construction to the Skogman project. Additionally, it included her alleged promise to commit the remainder of the \$40,000 toward Midwest Plumbing to whom they purportedly owed \$92,000. The facts establish that Mrs. Glew went to see Mr. Skogman, in part, to get payment for all or a portion of the invoice. At the time she went to the office of Mr. Skogman, neither she nor Mr. Glew could have had any knowledge that Mr. Skogman would place conditions on the use of the payment. The facts do not allow the conclusion that Mr. Glew could have played a part in any alleged misrepresentation because of the timing of these events.

It is the conclusion of this Court that Charles Glew had no involvement and no knowledge of any alleged fraudulent misrepresentation made by Sheryl Glew. Jomo Investments, Inc. cannot establish that Charles Glew made a misrepresentation nor that he had the intention to deceive. The claim of Jomo Investments, Inc. against Charles Glew, therefore, fails and the alleged debt to Jomo Investments, Inc. is dischargeable as to Charles D. Glew.

The Court will next examine the circumstances surrounding the November 1, 1995 conversation between Sheryl Glew and William Skogman. These circumstances do not support a finding that the parties agreed that the money was to be used for the restrictive purposes alleged by Jomo. The initial focus of the conversation was about Midwest Plumbing's tardily filed invoices on other projects and Debtors' company's subsequent cash flow problems. The conversation then migrated toward payment of the invoice on the current project as well as payment to ReVosWel. The record establishes that only Sheryl Glew and William Skogman were direct parties to the conversation. Vicki Stebral did overhear a part of the final conversation. Ms. Stebral prepared the check at Mr. Skogman's request and heard Sheryl Glew state that she would pay ReVosWel and Midwest Plumbing. Mr. Skogman testified that he gave Sheryl Glew the check premised upon her commitment to pay all of the ReVosWel account which was incurred on the basis of the present project and the remainder of the funds would go to Midwest Plumbing toward delinquent accounts. It is his position that Sheryl Glew made such a commitment. Sheryl Glew testified that, during the conversations with Mr. Skogman, she had become upset and had gone to the restroom. When she returned, Mr. Skogman gave her a check for \$40,000. During this entire conversation, there had been discussions concerning payment of ReVosWel and payment toward the Midwest Plumbing account. However, she testified that these discussions were general and there was no specific agreement as to which

funds would be used for what purpose. She testified that, as she was leaving, she thanked Mr. Skogman and told him that she would try to make payments toward the plumbing bill and ReVosWel though she did not understand that the money was given on any special condition. The evidence establishes that after receipt of the check, it was deposited in the Glew Construction Co. account and checks were issued to suppliers. Two payments were made to ReVosWel totaling approximately \$22,000 and \$1,800 was paid to Midwest Plumbing.

It is clear from the record that all three individuals, who have some knowledge of this conversation, believe that they have an accurate recollection of what occurred. In fact, the testimony of all three individuals is similar and the differences are sometimes subtle. It is obvious from the recitations of these individuals that this conversation was held over a brief period of time and under relatively emotional circumstances. The issue in controversy is extremely narrow and subject to interpretation. For example, in many respects Ms. Stebral's recollection is as consistent with Debtors' recollection as it is with Mr. Skogman's in that payments were actually made to ReVosWel and Midwest Plumbing. It is difficult to premise a finding of fraudulent misrepresentation on such ambiguous comments. Even then, the issue is not solely whether the statement was made, but whether it was intentionally misrepresented. This Court cannot conclude, based upon the record presented, that Mrs. Glew made a false representation with the intent to fraudulently obtain funds from Plaintiff.

Jomo must also establish that it justifiably relied on representations by Debtors. Mr. Skogman is experienced in the construction industry. Lien waivers are the typical form of assurance needed to be satisfied that a contractor has paid off a materials supplier on a building project. Mr. Skogman did not request a ReVosWel lien waiver from Mrs. Glew. The parties did not have a formal written contract requiring Debtors to pay materials suppliers first from any payments from Jomo, or to supply lien waivers after receiving payment. When he gave the \$40,000 Jomo check to Mrs. Glew, Mr. Skogman knew Debtors' company was having financial difficulties. Based on this record, the Court cannot conclude that Jomo has proven that it relied on any representations made by Mrs. Glew or that any purported reliance was justifiable.

Finally, Jomo must prove it sustained injury as a proximate result of Debtors' misrepresentations. Proximate cause exists if the creditor would not have suffered a loss without the debtor's representation. Van Horne, 823 F.2d at 1288. The representation must be a significant factor, in the absence of which the creditor would not have extended payment to the debtor. In re Adelman, 90 B.R. 1012, 1022 (Bankr. D.S.D. 1988). That is, absent the debtor's representations, the creditor's loss would not have occurred. Id. Damages include any liability arising from money fraudulently obtained. Cohen v. De la Cruz, 118 S. Ct. 1212, 1219 (1998) (including treble damages, attorney's fees and other relief that may exceed the value obtained by the debtor as damages for fraud under §523(a)(2)(A)); Morlang v. Cox, 222 B.R. 83, 86 (W.D. Va. 1998) (applying Cohen to calculate damages caused by unlicensed contractor's fraud).

Proximate cause is troublesome. Jomo concedes it owed Debtors payment on the agreement to build part of the building at 1100 Industrial Park. The question arises whether Jomo would have paid \$40,000 toward Debtors' invoice of \$63,873 in the absence of any representations by Mrs. Glew that she would pay off the debt to ReVosWel on the project. Jomo was liable to Debtors for their work on the project and the project was substantially completed at the time Jomo gave Mrs. Glew the \$40,000 check. Also, Mrs. Glew's disclosure of Debtors' financial difficulties could have been an impetus for Mr. Skogman to issue the check to assist their business, as he considered himself a friend of Debtors at the time.

The issue of damages is equally troubling. Debtors contracted with Jomo for payment of \$63,873 in return for building the project at 1100 Industrial Park. With Debtors' work substantially completed, Jomo owed payment to Debtors. It paid \$40,000 to Debtors. Jomo now faces mechanic's lien litigation in state court for ReVosWel's claim of \$29,634. This lien, however, is not likely to be enforced in full because of ReVosWel's failure to file it within the time limits of the Iowa Code. Instead, Jomo will only be liable for ReVosWel's mechanic's lien to the extent it has not paid Debtor, or \$23,873 which is the remainder due under Debtors' building contract.

Jomo asserts it spent \$13,000 more to complete the project after Debtors failed to do so. Debtors assert they completed the project according to their agreement with Jomo. Debtor Charles Glew testified that further work was required by city inspectors which was not part of Debtors' contract with Jomo. The plans for the project, drawn up after the parties made their contract, support Mr. Glew's version. Additionally, serious issues exist whether these alleged defects in the building project have any causal relationship to the alleged misrepresentation. The record amply supports the conclusion that little, if any, work was done on this project after November 1, 1995; the alleged date of the misrepresentation. There

exists no causation between the alleged misrepresentation and purportedly faulty construction work. The Court must conclude that Jomo has failed to prove it was damaged or that any damages were the proximate result of Mrs. Glew's representations.

In summary, the parties have presented different versions of the events surrounding Jomo's payment of \$40,000 to Debtors. Jomo has failed to prove that its version is more likely to have occurred. During the November 1 conversation between Mr. Skogman and Mrs. Glew, they talked about Debtors paying ReVosWel and Midwest Plumbing. The record does not support the conclusion that Mrs. Glew obtained the funds by falsely representing that she would only use the funds in that manner. Debtors made some payments to these entities. The payments to ReVosWel, however, were not credited to amounts due on the 1100 Industrial Park project. The parties had also discussed Debtors' general financial difficulties. It is equally as reasonable to conclude Mr. Skogman paid the \$40,000 because it was genuinely payable or out of friendship.

Furthermore, Jomo has failed to prove it has suffered a loss. While the Court need not determine the merits of the lien issue, it is likely that Jomo will not be liable to ReVosWel beyond the total contract price. Debtors had substantially completed the project and Jomo was liable to pay the complete contract price. Other work for a vapor barrier and fire wall were required by city inspectors and were not the result of any action by Debtors. And, ultimately, these are issues involving workmanship and have no direct causal relationship to the alleged misrepresentation.

WHEREFORE, Plaintiff Jomo Investments, Inc. has failed to prove the elements of §523(a)(2)(A) by a preponderance of the evidence.

FURTHER, Plaintiff's Complaint to except its claim from discharge is DENIED.

SO ORDERED this 27th day of August, 1998.

PAUL J. KILBURG

Paul J. Kilburg
U.S. Bankruptcy Judge