In the United States Bankruptcy Court

for the Northern District of Iowa

JOHN MEYER SHELLI MEYER *Debtor(s).*	Bankruptcy No. 99-00980-W Chapter 7
RICHARD MADSEN LOUANNE MADSEN *Plaintiff(s)* vs. JOHN MEYER dba CABINETS UNLIMITED *Defendant(s)*	Adversary No. 99-9067-W

ORDER

On November 28, 2000, the above-captioned matter came on for hearing pursuant to assignment. Plaintiffs Richard and Louanne Madsen appeared in person with their attorney, Mark Rolinger. Defendant/Debtor John Meyer appeared in person with his attorney, Gary McClintock. Evidence was presented after which the Court took the matter under advisement. The time for filing briefs has now passed and the matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I).

STATEMENT OF THE CASE

This adversary proceeding is brought pursuant to 11 U.S.C. §523(a)(2)(A) and §523(a)(6). A broad statement of the facts establishes that Plaintiffs entered into a contract with Debtor in which Debtor was to provide kitchen cabinets and other interior woodwork for Plaintiffs' new home. The work was not provided and Plaintiffs assert their claim is excepted from discharge.

FINDINGS OF FACT

Mr. and Mrs. Madsen live in Denver, Iowa. They purchased a lot in Rustic Hills to construct a new home. They served as their own general contractor and hired subcontractors. They met Debtor John Meyer, dba Cabinets Unlimited, at a home show in Waterloo, Iowa. They entered into negotiations and on March 30, 1998, Mr. Meyer submitted a proposal for cabinetry for the new kitchen, laundry, den, and bathrooms. The bid price was $29,547. (Plaintiffs' Exhibit 2). Debtor asked for and received a downpayment of $14,700 which Plaintiffs paid on April7, 1998. Debtor does not deny that, at the time of the initial proposal and deposit, he represented to Plaintiffs that the initial deposit would be used to purchase raw materials and to provide labor. It is alleged and not denied by Debtor that he

represented that he would complete the work contracted by the fall of 1998. He also represented that he had three men working for him in the completion of this project.

After the execution of the contract, contact with Debtor became more difficult. Between April and June of 1998, Plaintiffs had little contact with Debtor. When they were able to contact him, he indicated that work was being done on the cabinets.

In June, Debtor made a proposal to expand the original contract. Plaintiffs' initially intended to use cherry wood in the kitchen. The remainder of the home would have oak doors, oak trim and oak moldings. Debtor suggested that they consider doing the entire interior in cherry and made a proposal to that effect. (Plaintiffs' Exhibit 4). The additional work totaled $11,060.04 with a downpayment of $5,530. The proposal was accepted by Plaintiffs on August 13, 1998, after which they paid the additional downpayment to Debtor. Again, Debtor said that he would order the materials with the downpayment to prepare the various items listed in Exhibit 4 so they would be ready to be installed in the home at the appropriate time.

Plaintiffs had a difficult time remaining in contact with Debtor. Most communication was by way of answering machines. On August 25, 1998, Mrs. Madsen received a telephone call from Mr. Norm Timson who was working for Cedar Valley Bank and Trust. This was the first time that Plaintiffs became aware that there may be difficulty with Debtor's contracts. Mr. Timson informed Plaintiffs that Debtor was having financial problems. He advised them that the Bank held security interests in various parts of Debtor's business and the Bank would probably foreclose in September. Plaintiffs became alarmed and attempted to contact Debtor, without success. On August 28, 1998, Mrs. Madsen went to Debtor's premises to personally talk to him. She was not able to locate him. While there, she looked in the shop. She did not see anything that looked like cherry wood or anything resembling cabinet bases or interior doors.

Mr. Meyer called Plaintiffs on August 31 and left a message on their home answering machine. He said that the wood had been sent out for sanding and would be back in a week or so. He also left a message that the wood would be ready for staining and that Plaintiffs should make inquiries to get the proper color. Plaintiffs tried to respond but were unsuccessful.

Mrs. Madsen contacted Mr. Timson on September 2. He informed her that he had been out to Debtor's shop but didn't see anything that resembled her woodwork. He also told her that Debtor was being evicted. This eviction was not initiated by the Bank but by Debtor's real estate contract seller. Mrs. Madsen called the Sheriff who confirmed Debtor's eviction.

Plaintiffs contacted their attorney, Mr. Rolinger, who sent a letter to Debtor on their behalf seeking a return of either the downpayment or the cabinets. On September 4, Mrs. Madsen went to the Sheriff's Department and was advised that they had been on the property but did not see any cabinets which belonged to her. Thereafter, Mrs. Madsen attempted to arrange an inspection of the premises vacated by Debtor. On September 10, she was informed by the Sheriff's Department that there was no reason for an inspection as there was nothing of value left on the premises.

Mrs. Madsen attempted to find Debtor. She drove to Dysart, Iowa in an attempt to locate him but was unsuccessful. Plaintiffs did not receive any return of their downpayments nor did they ever receive any of the cabinetry or other woodwork. Their attorney, Mr. Rolinger, filed a lawsuit on their behalf in Black Hawk County District Court. Plaintiffs received a default judgment against Debtor on December 24, 1998 in the amount of $20,230 plus attorney fees in the amount of $564.24.

Plaintiffs were not aware, until the end of August 1998, of Debtor's tenuous financial position. Debtor had been banking with the Cedar Valley Bank and Trust since 1993. The Bank provided periodic financing for Debtor's business. Mr. Jeffery Laritson, a banker with Cedar Valley Bank and Trust, testified that by 1997 Debtor's financial picture was becoming bleak. The Bank had security interests in most of the projects on which Debtor was working. From 1997 into 1998, Debtor was primarily working on four projects, not including Plaintiffs'. These projects were not being completed and threats of lawsuits were becoming frequent. Mr. Laritson testified that they made their last loans to Debtor in 1997 based on the premise that the jobs currently underway would have to be finished expeditiously. Several of these jobs were to be completed by the end of 1997 but were not. In fact, several of these projects were never completed. As early as February, 1998, Mr. Laritson had a meeting with Debtor in which he suggested that Debtor should close his business and seek employment in a salaried position. The notes of that meeting reflect that Mr. Meyer said that he was considering that option and was considering getting a salaried position in Cedar Rapids.

It was while Debtor was already in financial crisis that he entered into the first contract with Plaintiffs in April of 1998. When he received the $14,700 downpayment from Plaintiffs, he did not deposit the funds with his Bank, the Cedar Valley Bank and Trust. Instead, Debtor opened a new account at Dysart State Bank without informing Cedar Valley Bank and Trust either of the fact he had entered into a new contract or that he had changed his bank to Dysart State Bank. When Debtor opened this new account at Dysart State Bank, he did not do so with the intention of seeking supplemental financing. He never did discuss supplemental financing with Dysart State Bank. This series of transactions occurred even though Mr. Laritson testified that it was financially impossible for Debtor to finance a $40,000 project without involving a Bank for remedial financing. Thus, at the time Debtor opened the bank account at Dysart State Bank, the Cedar Valley Bank and Trust had refused any further extension of credit and Dysart State Bank was not approached for that purpose.

Debtor deposited the $14,700 in the new checking account on April 9, 1998. This was the first activity in this account and, on the same date, Debtor made withdrawals including a $500 cash withdrawal. It is unnecessary to detail all of the activity in this account. It is fair to state that, of the numerous entries, very few can be colorably considered as being for the purpose of buying materials for the construction of cabinets. Many of the withdrawals are for cash. Some are for apparent business expenses such as utilities. A large portion of funds went to Krug Racing which, by Debtor's own admission, were based upon Debtor's interest in racing automobiles and had nothing to do with his business interests. The Bank records reflect that by June of 1998, within two months of the initial deposit, the entire $14,700 was depleted. There were several small deposits in the middle of June but thereafter, the account reflects largely overdraft checks until the second downpayment was made by Plaintiffs in August. Again, it is impossible to conclude from the Bank records that any materials were purchased toward the construction envisioned in Plaintiffs' contracts.

In early September, the real estate contract involving the land upon which his shop stood was forfeited and Debtor voluntarily vacated the premises. He was observed doing this by Mr. Timson of the Cedar Valley Bank and Trust. Mr. Timson observed a portion of the removal of equipment and other items from the premises. Richard and Carolyn Krafka, who lived near Debtor's property and oversaw the property on behalf of the contract seller, testified concerning the move. They observed the premises periodically as well as on the date when Debtor vacated the premises. All persons testifying concerning the move stated that they did not observe any items which resembled materials necessary to complete Debtor's contract with Plaintiffs. Mrs. Krafka testified that after Debtor vacated the premises, the locks were changed. After the premises were cleaned up, they were reoccupied

several months later. All witnesses were of the opinion that when Debtor left the premises, there was nothing left which resembled wood products to fulfill Plaintiffs' contract.

Debtor John Meyer testified that he entered into the contracts with Plaintiffs in good faith. He stated that he understood that the deposits made by Plaintiffs were to be used to purchase materials and labor. He admitted that he made this representation. He also admitted that he represented to Plaintiffs that he would complete the contracted work on their home by the fall of 1998 and that he had sufficient manpower to complete this project. Mr. Meyer testified that during the time he entered into the contract with Plaintiffs he was having financial difficulties. He admitted that he would not have been able to finance this $40,000 project without a bank loan.

He did maintain, however, that he took the money in good faith to purchase materials and build the items he had contracted to build. He maintained at trial that he had begun construction on these items and at the time he moved from the premises, the wood was at another subcontractor being sanded. He testified that it was at Fishel's and/or Corkery's Cabinet Shop in Jesup. He testified that, after the sanding, most of these project materials came to Debtor's shop. It is unclear, however, and Debtor did not clarify whether this was the shop which he vacated on September 3 or a subsequent shop. He testified that most of the wood products were left in the Dysart shop. Again, Debtor's testimony is vague as to where these materials were if they were, in fact. ever purchased. Mr. Meyer testified that he opened the Bank account at Dysart in good faith because Cedar Valley Bank and Trust would not provide any more financing. However, he admitted that he was unable to finance this project on his own. He never approached the Dysart State Bank for supplemental financing. He testified that the cost of materials is generally about 25% of the bid price.

SECTION 523(a)(2)(A)

Plaintiffs bear the burden to prove the elements of their claim under 11 U.S.C. §523 by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279, 285 (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).

Plaintiffs rely on § 523(a)(2)(A) as grounds for excepting their claim from discharge. This section states:

> (a) A discharge under section 727 . . . does not discharge an individual debtor from any debt
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> . . .
>
> (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) (1993). In the Eighth Circuit, a creditor proceeding under §523(a)(2)(A) must prove the following elements:

> (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.

Van Horne, 823 F.2d at 1287, as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that "§ 523(a)(2)(A) requires justifiable, but not reasonable, reliance").

SECTION 523(a)(6)

Plaintiffs allege §523(a)(6) applies to the facts in this case. This section states in applicable part:

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

this title does not discharge an individual debtor

from any debt -

. . .

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

Recent decisions by the United States Supreme Court and other courts have established high standards to hold an obligation nondischargeable under this section. Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998). To satisfy the willfulness component of §523(a)(6), the conduct in question must be an intentional act traditionally defined as an intentional tort. Intent, as used in the Restatement (Second) of Torts, refers to the consequences of a tortious act rather than the act itself. The Restatement (Second) of Torts defines intent as follows: "The word 'intent' is used throughout the Restatement of this subject to denote that the actor desires to cause consequences of his act, or that he believes that the consequences are substantially certain to result from it." Restatement (Second) of Torts §8A (1964).

If the record establishes that the conduct complained of is an intentional tort, the willfulness component of §523(a)(6) is satisfied. Something additional is necessary, however, above and beyond the willfulness component to satisfy the maliciousness component of §523(a)(6). The Eighth Circuit strongly suggests that in order to satisfy the maliciousness component of §523(a)(6), the claimant must establish that the tortious conduct was "targeted at the creditor". In re Long, 774 F.2d 875, 881 (8th Cir. 1985). This Court has concluded that if an intentional tort is established and the debtor's conduct was targeted at the creditor, the requirements of §523(a)(6) are satisfied. In re Lease, Adv. No. 98-9002-W, slip op. at 9 (Bankr. N.D. Iowa July 21, 1998).

CONCLUSIONS UNDER §523(a)(2)(A)

Plaintiffs have satisfied the first three elements of §523(a)(2)(A). The Court finds that Debtor knowingly made false representations, intending Plaintiffs rely on them. Debtor told Plaintiffs that the initial deposit would be used to purchase raw materials and labor for the portion of the building project that he contracted to complete. There is no evidence that any raw materials were purchased with the downpayment funds, or that Debtor ever began the promised work. Moreover there is

evidence clearly demonstrating that Debtor spent most, if not all of the money from the initial payment, on purchases other than materials and labor.

Debtor claims that he purchased and sent the materials out for sanding, but there was no showing made that the materials were ever purchased, nor does Debtor provide a satisfactory explanation for their current whereabouts. Debtor deposited the sum of the advance payments (minus the amount withdrawn in cash) into a single account. From that account, money was paid to an auto racing group, auto parts stores, and numerous cash withdrawals. Debtor has no record of whether labor paid from this account actually went to Plaintiffs' project. The overwhelming weight of the evidence establishes that Plaintiffs' downpayment was not used for materials and labor under the parties' contracts.

Debtor told Plaintiffs that he was making progress on the cabinets, but the evidentiary record fails to show that any work on the cabinets ever took place. When Debtor bid on Plaintiffs' project, he had several other jobs that remained unfinished. Other dissatisfied customers had threatened legal action. When Debtor spent Plaintiffs' entire initial downpayment, he convinced Plaintiffs that he was making progress, and that they should expand the project. The expanded project involved a second downpayment by Plaintiffs of $5,530 for labor and materials.

The Court finds that Debtor knew he could not complete this project when he bid on it or when he expanded it, yet he told Plaintiffs that he would complete it by the fall of 1998. Debtor admitted the need to arrange outside financing for the completion of this project. Debtor's banker told him that he would not be able to finance any new projects because of his financial situation. Despite the admitted necessity of outside financing to complete this job, Debtor never attempted to arrange financing. Taken as a whole, these acts demonstrate Debtor's requisite intent to deceive Plaintiffs and induce them to rely on his misrepresentations.

The fourth element under § 523(a)(2)(A) is satisfied by this record. Plaintiffs justifiably relied on Debtor when they made their initial payments. Plaintiffs were functioning as their own general contractor, arranging subcontractors to perform work on their home. Debtor was a subcontractor who had performed this type of work. Debtor presented himself as qualified to take on and complete Plaintiffs' job while submitting a bid that Plaintiffs found reasonable.

Plaintiffs had no way of knowing that Debtor's own banker had already advised him to find employment working for someone else and to abandon his business as an independent contractor. Because Debtor switched banks, inquiry into Debtor's business history at Dysart State Bank would not have produced information relating to Debtor's unsatisfied former clients. Unless Debtor disclosed their names, Plaintiffs had no means of discovering Debtor's unsatisfactory work history.

The final element under § 523(a)(2)(A) is also satisfied. Debtor's fraud is the proximate cause of Plaintiffs' damages. The debt to Plaintiffs' is the amount of money paid to Debtor as advance money for materials and work. Had Debtor not fraudulently represented to Plaintiffs that he could perform the work that he bid, they would not have advanced him the money for materials. Therefore, Plaintiffs have proven all of the necessary elements under § 523(a)(2)(A) to except their claim from discharge.

CONCLUSIONS UNDER §523(A)(6)

Because the Court finds that Plaintiffs have proven all of the elements necessary under § 523(a)(2)(A) for an exception from discharge, it is unnecessary to discuss at great length whether Debtor's behavior also warrants an exception from discharge under §523(a)(6). However, the Court will briefly examine the intentional tort aspect of Debtor's conduct.

Under case law, Plaintiffs must show that Debtor's conduct was malicious. To establish malicious conduct, Plaintiffs must show that Debtor's tortious conduct was targeted at the creditor. In this case, the Court has concluded that Debtor fraudulently and intentionally misled Plaintiffs in their business relationship. However, there is a complete absence of any evidence in this record to establish that Debtor's conduct was targeted at Plaintiffs. A more reasonable interpretation of the record establishes that Debtor was in severe financial trouble and that he entered into the contracts with Plaintiffs to obtain a ready source of cash. Debtor's motives were purely self-serving, but exhibited no particular animus toward Plaintiffs. As such, Plaintiffs' claim under §523(a)(6) must fail. As this element is missing and as the Court has determined the claim is nondischargeable under §523(a)(2)(A), it is not necessary to discuss the remaining elements of §523(a)(6).

WHEREFORE, for the reasons set forth herein, the claim made by Plaintiffs Richard and Louanne Madsen against Debtor/Defendant John Meyer is established by a preponderance of the evidence and the Complaint is GRANTED.

FURTHER, the judgment entered in favor of Plaintiffs and against Debtor in Black Hawk County District Court on December24, 1998 in the amount of $20,230, plus attorney fees in the amount of $564.24, is excepted from Debtor's discharge.

SO ORDERED this 27th day of December, 2000

Paul J. Kilburg
Chief Bankruptcy Judge