

IT IS SO ORDERED.

Dated: 02:15 PM September 26 2011

  
MARILYN SHEA-STONUM *JS*  
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION

IN RE:	)	CASE NO. 10-55126
	)	
DARRELL R. STOUT,	)	CHAPTER 7
	)	
DEBTOR.	)	
	)	
THERESA KNAPP,	)	ADVERSARY NO. 10-5171
	)	
PLAINTIFF,	)	JUDGE MARILYN SHEA-STONUM
	)	
v.	)	
	)	
DARRELL R. STOUT,	)	
	)	
DEFENDANT.	)	<u>MEMORANDUM OPINION</u>

This matter is before the Court on the complaint of Theresa Knapp (“Plaintiff”) seeking a determination that the debt owed to Plaintiff by the Debtor, Darrell R. Stout (“Stout”), is excepted from Stout’s discharge pursuant to 11 U.S.C. § 523(a)(2)(A). Thomas Loepp appeared as counsel for Plaintiff and Ben Manayan and Vincent Vigluicci appeared as counsel for Stout. During the trial, the Court heard testimony from Plaintiff and Stout and received evidence in the form of exhibits and stipulations. At the conclusion of the trial, the Court took the matter under advisement.

This proceeding arises in a case referred to this Court by the Standing Order of Reference entered in this District on July 16, 1984. This matter is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A) and (I) over which this Court has jurisdiction pursuant to 28 U.S.C. § 1334(b). Based upon the parties' stipulations [docket #26], the testimony and evidence presented at the trial, the arguments of counsel, the pleadings in this adversary proceeding and debtor's main chapter 7 case and pursuant to Fed. R. Bankr. P. 7052, the Court makes the following findings of fact and conclusions of law.

### **FACTS**

Debtor, Darell R. Stout was the owner and president of Stout Custom Homes. Stout Custom Homes built a home located at 191 Melbourne Avenue in 2007.

On March 15, 2007, Unified Construction Systems, Ltd., dba Foundation Systems, installed a TUFF-N-DRY Basement Waterproofing System on the home. Tremco Barrier Solutions was, and is, the manufacturer of TUFF-N-DRY Basement Waterproofing System that was installed on the home.

Also in March 2007, after the waterproofing had been installed, while the home was being built, a subcontractor working at the building site drove a skid steer onto the overdig, the area between the foundation wall and the excavated dirt. This caused dirt to put pressure on the home's north foundation wall and caused the wall to crack. In June 2007, Stout hired Todd Miller of T&M Masonry to repair the crack in the north wall. The repair was a "soap" repair, meaning that the faces of the cracked cinderblocks were repaired, not the whole cinderblocks.

Plaintiff Theresa Knapp saw the home for the first time in July 2007, she viewed the home's interior and exterior, including the basement. Plaintiff made clear to Stout that it was important to

her that she have a dry basement that she could use as living space. Stout represented to Plaintiff that the basement could be finished. To that end, Plaintiff and Stout also discussed Stout's side business of finishing basements for use as living space. Also, Stout informed the Plaintiff that the basement had been waterproofed and that the house was covered by a waterproofing warranty from Tremco. Stout did not mention the damage caused by the skid steer, nor the soap repair made by T&M Masonry.

On August 3, 2007, Plaintiff Theresa Knapp signed a written Agreement for Purchase and Sale of Real Estate pursuant to which she agreed to purchase the home located at 191 Melbourne Avenue, Ohio 44313 from Daneen Stout, the Debtor's sister. Exhibit A.

On August 9 or 10, 2007, Stout noted a water problem in the basement of the home. He contacted Foundation Systems, the company who had waterproofed the house with Tremco's product. Stout did not tell Plaintiff about the water problem in basement of the home. Stout testified that he contacted Foundation Systems because at that time he believed there was a problem with the waterproofing.

As a part of the sale process, Plaintiff had engaged the services of a home inspector to inspect the home, interior and exterior, including the basement. On August 13, 2007, Plaintiff's home inspector inspected the home. His report indicates that the walls were wet. Stout, who was present at the time of the home inspection, claims that the walls were wet because he had just washed the basement floors and water splashed onto the walls. The report from the home inspector indicates that the walls were just washed down. Defendant's Exhibit 10, p.6. As a result, the home inspector was prevented from assessing whether moisture was a problem in the basement.

On August 20, 2007, unbeknownst to Plaintiff, Wes Weingart from Foundation Systems conducted a flood test at the house. The house failed the flood test. Stout still did not disclose to Plaintiff the water problems in the basement or the results of the flood test. Stout claims that he

believed the flood test failure was the result of unfinished grading around the house, which belief is inconsistent with his actions on August 9 or 10, 2007 when he contacted Tremco. The Court does not credit Stout's testimony in this respect. A flood test failure could not be attributable to the grading around the house, as it apparently consists of placing a hose against the foundation, below grade level. Notwithstanding Stout testified that he believed he made a "repair" by completing the final grading around the house between August 24 and 27, 2007. The Court does not credit this testimony either.

On August 27, 2007, Plaintiff completed the final walk through of the house and signed a Limited Home Warranty Agreement, an Addendum to Warranty Coverage and a Limited Home Warranty Consent Form which were provided to her by Stout. Exhibit B. On August 27, 2007, along with the Limited Home Warranty Agreement, Addendum to Warranty Coverage and Limited Home Warranty Consent Form, Plaintiff also received a copy of the Construction Standards and Maintenance Guide from Stout. Exhibit C.

On or about September 5, 2007, Plaintiff and Daneen Stout closed on the Agreement for Purchase and Sale of Real Estate dated August 3, 2007. On October 26, 2007, Plaintiff received a copy of the warranty documents from Tremco Barrier Solutions regarding the TUFF-N-DRY Basement Waterproofing System that was installed on the home. Exhibit D. Soon thereafter, the Plaintiff discovered water problems in the basement. The Plaintiff notified Stout about the problems with water in the basement. The parties had various conversations, mostly by email, about the water problems. On July 28, 2008, Stout applied a waterproofing material to the exterior above-grade portion of the foundation. Although the water problems along the south wall of the home appear to have been resolved, the water problems along the north wall of the home continue and according to

the Plaintiff's testimony are worse. The undisputed testimony is that water pools in the northeast corner of the basement. The Plaintiff has not been able to finish her basement.

The Plaintiff testified that had she known about the water problems in the basement, she would have negotiated a different deal with Stout for the purchase of the home.

On November 20, 2008, Plaintiff filed a complaint against Stout, among others, in Summit County Court of Common Pleas for violation of the consumer sales practices act, breach of contract, fraud in the inducement, intentional, reckless or negligent misrepresentation. That matter was stayed when the Stout filed his Chapter 7 bankruptcy on October 27, 2010.

Plaintiff commenced this adversary proceeding on December 1, 2010 seeking to have the Court determine that the debt owed to her by Stout is not dischargeable under 523(a)(2).

### **DISCUSSION**

Debts for money, property, or services to the extent obtained, by false pretenses, a false representation, or actual fraud are excepted from a debtor's chapter 7 discharge. 11 U.S.C. § 523(a)(2)(A). As exceptions to discharge are strictly construed against the creditor, a creditor seeking to except a debt from discharge under § 523(a)(2)(A) must prove by a preponderance of the evidence that: [1] the debtor obtained money through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; [2] the debtor intended to deceive the creditor; [3] the creditor justifiably relied on the false representation; and [4] its reliance was the proximate cause of the loss. *Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 280-81 (6th Cir. 1998); *Longo v. McClaren (In re McLaren)*, 3 F.3d 958, 961 (6th Cir. 1993).

***[1] The debtor obtained money through a material misrepresentation that, at the time, the debtor***

***knew was false or made with gross recklessness as to its truth.***

A “false pretense” involves an implied misrepresentation or conduct intended to create or foster a false impression. *In re Cole*, 164 B.R. 951, 953 (Bankr.N.D.Ohio 1993) (citing *In re Begun*, 136 B.R. 490 (Bankr.S.D.Ohio 1992)); *In re McCoy*, 114 B.R. 489, 490 (Bankr.S.D.Ohio 1990). By comparison, a “false representation” involves an expressed misrepresentation by a debtor. *In re Begun*, *id.* (citing *In re Dunston*, 117 B.R. 632, 639–40 (Bankr.D.Colo.1990)). Notably, a debtor's silence may constitute a materially false representation thus prohibiting discharge of indebtedness. *In re Begun*, *id.* (citing *In re McCoy*, 114 B.R. at 489). On the other hand, “actual fraud” has been defined to include a “deception intentionally practiced to induce another to part with property or to surrender some legal right, and which accomplishes the end designed.” *In re Cole*, 164 B.R. 951, 953 (citing *United States v. Lichota*, 351 F.2d 81 (6th Cir.1965), cert. denied, 382 U.S. 1027, 86 S.Ct. 647, 15 L.Ed.2d 540 (1966)).

*Blascak v. Sprague (In re Sprague)*, 205 B.R. 851, 859 (Bankr. N.D. Ohio 1997).

In this case, Stout remained silent about the water problems in the basement. He did not tell Plaintiff about the damage to the north wall that occurred in March 2007. He did not tell the plaintiff about the flood test failure. Rather he represented to her that she could finish the basement and use it as living space, and he told her that there was a waterproofing warranty in place. He kept the information about water problems in the basement to himself, despite his knowledge that Plaintiff wanted a dry basement suitable for use as a living space and his representation to her that it could be used in that fashion.

***[2] The debtor intended to deceive the creditor.***

Debtor’s rarely admit they intended to deceive, therefore, when there is no direct testimony regarding the debtor’s intent, the intent of the debtor can be inferred from the evidence presented to the Court. *See Fifth Third Bank v. Collier (In re Collier)*, 231 B.R. 618, 623 (Bankr. N.D. Ohio 1999); *Blascak v. Sprague (In re Sprague)*, 205 B.R. 852, 861 (Bankr. N.D. Ohio 1997).

An intent to deceive may logically be inferred from a false representation or false

pretense which the debtor knows or should know will induce another individual to part with property (or services). *First Nat'l. Bank v. Kimzey*, 761 F.2d 421, 424 (7th Cir.1985). A “false pretense” involves an implied misrepresentation or conduct intended to create or foster a false impression. *Howard & Sons, Inc. v. Schmidt (In re Schmidt)*, 70 B.R. 634, 640 (Bankr.W.D.Ind.1986); *Minority Equity Capital Corp. v. Weinstein (Matter of Weinstein)*, 31 B.R. 804, 805 (Bankr. E.D. N.Y.1983). A false pretense has been defined to include a “mute charade,” where the debtor's conduct is designed to convey an impression without oral representation. *In re Thomas*, 12 B.R. 765, 769 (Bankr. N.D. Ga.1981). A “false representation,” on the other hand, is an expressed misrepresentation. It need not be a written misrepresentation; oral misrepresentations have been found to be actionable. *In re Falk of Bethlehem*, 3 B.R. 266, 274 (Bankr D.N.J.1980); *See L. King, 3 Collier on Bankruptcy*, Para. 523.08, 523–48 (15th ed. 1989). Even a debtor's silence may constitute a materially false misrepresentation prohibiting discharge of the indebtedness.

*James v. McCoy (In re McCoy)*, 114 B.R. 489, 498 (Bankr. S.D. Ohio 1990)

In this instance, the Court infers from the evidence presented that Stout intended to deceive the Plaintiff. The Court finds that although Daneen Stout was listed on the home's deed as its owner, Stout, as the owner and president of Stout Custom Homes, the builder of the home, would benefit from the sale of the home at the best possible price. In addition, not only did he fail to give the plaintiff complete information about the state of the basement of the home, but by his own testimony, he took action on the day of the home inspection that prevented the Plaintiff's home inspector from determining whether water was entering the basement. Also, following the flood test failure, Stout, despite his assertions to the contrary, knew that there was a problem with the foundation wall, not with the grading, and he failed to share this information with Plaintiff prior to closing on the sale of the home. Stout testified that he expected the Plaintiff to rely on his representations regarding the state of the basement and that he was aware that she wanted the basement to be a dry living space.

***[3] The creditor justifiably relied on the false representation and , as a result, plaintiff suffered a loss.***

Justifiable reliance is different from reasonable reliance. *Fellows, Read & Associates, Inc. V. Rieder*, 194 B.R. 734 (S.D. N.Y. 1996) aff'd 116 F.3d 465 (2<sup>nd</sup> Cir. 1997). Justifiable reliance is a subjective standard; it is a less stringent standard in between actual reliance and reasonable reliance.

*Id.*

Although the plaintiff's reliance on the misrepresentation must be justifiable ... this does not mean that his conduct must conform to the standard of the reasonable man. Justification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases. *Mans* at —, 116 S.Ct. at 444 (citing Restatement (Second) of Torts, § 545A, Comment b (1976)).

*In re Sprague*, 205 B.R. at 858. In *Sprague*, the bankruptcy court held, “a plaintiff has met the new standard of justifiable reliance if the plaintiff was justified in relying upon representations whose falsity, although ascertainable from some investigation, are nevertheless not ascertainable from a cursory glance or appearance to one of like knowledge and intelligence. *Field v. Mans*, 516 U.S. at —, 116 S.Ct. at 444.” *In re Sprague*, 205 B.R. at 862. Plaintiff met this burden of proof. The evidence clearly shows that plaintiff relied on Stout’s representations and did so justifiably. Her best opportunity to have ascertained the true state of the basement was obscured by Stout’s actions on August 13, 2007 when he took action specifically designed to prevent Plaintiff’s home inspector from determining whether moisture was leaking into the basement from the outside.

## CONCLUSION

Stout made representations to the Plaintiff about the suitability of the basement for use as finished living space. He knew at the time he made those representations and prior to the time the sale of the home closed, that those representations were false. He kept information from the Plaintiff about the state of the basement and the foundation walls. He did so with the intent to deceive the



Plaintiff about the state of the basement of the home. The Plaintiff was justified in her reliance on Stout's representations and as a result, Plaintiff has suffered loss, in whatever amount a state court determines appropriate. For these reasons, the Court determines that pursuant to 11 U.S.C. § 523(a)(2)(A), the debt owing to Plaintiff from Stout, in whatever amount a state court determines is appropriate, is excepted from Stout's discharge.

# # #

cc (*via* electronic mail):

Thomas Loepp, Counsel for Plaintiff-

Ben Manayan and Vincent Vigluicci, Counsel for Defendant