UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

In re:	)	Case No. 02-10977
	)	
CHARLES W. NADOLSKI,	)	Chapter 7
Debtor.	)	
	)	Judge Arthur I. Harris

ANDREW M. WOZNIAK and	)	Adversary Proceeding No. 02-1247
DIANE E. WOZNIAK,	)	
Plaintiffs,	)	
	)	
v.	)	
	)	
CHARLES W. NADOLSKI	)	
dba NADOLSKI BUILDERS,	)	
Defendant.	)	

ROBERT HARGRAVE and	)	Adversary Proceeding No. 02-1248
KAREN HARGRAVE,	)	
Plaintiffs,	)	
	)	
v.	)	
	)	
CHARLES W. NADOLSKI	)	
dba NADOLSKI BUILDERS,	)	
Defendant.	)	

MEMORANDUM OF OPINION

The plaintiffs Andrew Wozniak and Diane Wozniak (the Wozniaks) and Robert Hargrave and Karen Hargrave (the Hargraves) filed the instant complaints on July 12, 2002, seeking a determination of liability against the defendant/debtor Charles Nadolski and objecting to the discharge of such liabilities. Given the

factual similarity of the complaints, parties, and the circumstances involved in both cases, the Court permitted the two adversary proceedings to be briefed and conducted jointly. The complaints allege that the debtor, through false representations, defrauded the plaintiffs while constructing their log homes. The Court conducted a trial on both adversary proceedings on November 5 and 7, 2003, and thereafter permitted the parties to file post-trial briefing on or before December 3, 2003. The debtor timely filed his post-trial brief (Wozniak Docket # 31; Hargrave Docket # 25), but the plaintiffs did not file their post-trial briefing until February 4, 2004 – nearly three months after the original deadline (Wozniak Docket # 37; Hargrave Docket # 31).

For the reasons that follow, the $38,517.09 debt owed by the debtor to the Hargraves by virtue of the "Settlement Agreement and Release" dated June 22, 2001, is a nondischargeable debt pursuant to 11 U.S.C. § 523(a)(2)(A), and any alleged debt from the debtor's construction of the Wozniaks' log home is a dischargeable debt. With respect to the debtor's counterclaim against the Wozniaks, the Court finds in favor of the Wozniaks and against the debtor.

PROCEDURAL BACKGROUND AND JURISDICTION

On February 1, 2002, the debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. These adversary proceedings were

commenced on July 12, 2002, to determine the dischargeability of certain debts under § 523(a)(4) and (a)(6) of the Bankruptcy Code and to require "an accounting for the funds expended by Plaintiffs and drawn down by Defendant in connection with the work on Plaintiff's project." These cases were transferred to the undersigned judge on October 7, 2002. This memorandum constitutes the Court's findings of fact and conclusions of law as required by Rule 7052 of the Federal Rules of Bankruptcy Procedure.[1]

Although both sets of plaintiffs sounded their complaints under 11 U.S.C. § 523(a)(4) (fraudulent malfeasance of fiduciary, embezzlement, and larceny) and (a)(6) (willful and malicious injury), all three parties fashioned their briefs and presented their evidence at trial as if the complaints had alleged violations of 11 U.S.C. § 523(a)(2)(A) (obtaining money through false representations or actual fraud). Given that the debtor never objected to the introduction or presentation of evidence regarding alleged violations of 11 U.S.C. § 523(a)(2)(A), the Court finds that such matters were tried with the debtor's implied consent. *See, e.g.*, FED. R.

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[1] The findings of fact contained in this memorandum reflect the Court's weighing of the evidence and credibility. In so doing, the Court considered the witnesses' demeanor, the substance of their testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language, or nuance of expression. Even if not specifically mentioned in this decision, the Court has considered the testimony of all the witnesses at trial, as well as all exhibits admitted into evidence and all stipulations.

CIV. P. 15(b) (incorporated into bankruptcy proceedings by Bankruptcy Rule 7015); *Papio Keno Club, Inc. v. City of Papillion* (*In re Papio Keno Club*), 262 F.3d 725, 729 (8th Cir. 2001) (recognizing that issues unraised in the pleadings are tried by implied consent where a party fails to object at trial to their introduction or to the presentation of evidence relevant to the issues); *Graffice v. Grim* (*In re Grim*), 293 B.R. 156, 162 (Bankr. N.D. Ohio 2003) (Speer, J.) (applying Federal Civil Rule 15 in context of § 523(a)(2) proceeding).

The Court has jurisdiction in these adversary proceedings pursuant to 28 U.S.C. § 1334(b) and Local General Order No. 84, entered on July 16, 1984, by the United States District Court for the Northern District of Ohio. These are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(B) and (I).

WOZNIAK FACTS

The Wozniaks first came into contact with the debtor in the fall of 1999 when they looked into building a log home. The Wozniaks mailed in a business reply post card for Asperline Log Homes (Asperline), and the debtor contacted them in response to the inquiry. Holding himself out as a "log cabin specialist" who had constructed over 60 log cabins, the debtor offered to construct a "Retreat" log home – the Asperline model desired by the Wozniaks – for approximately $103,000.00. In truth, however, the debtor had not constructed any log homes at

the time he negotiated with the Wozniaks, but he did have experience with his father's construction company in making additions and modifications to existing log homes, as well as building conventional "stick-frame" homes. In addition to doing construction work, the debtor is employed as a surgical assistant at the Bedford Medical Center.

After more consultation, the debtor and the Wozniaks entered into a "Purchase Option Agreement" on September 19, 1999, wherein the Wozniaks paid $1,500.00 to the debtor in order to start the construction process and to secure a favorable price. *See* Plaintiff's Exhibit W-1. Part of the agreement involved a plan for the Wozniaks to purchase from the debtor 4.6 acres of real estate for their log home and to finance this purchase through a home equity line of credit secured by the Wozniaks' residence in Parma, Ohio. Evidently, the debtor owns or owned 30 acres of real estate in two different locations in Ohio. In early 2000, the Wozniaks purchased real estate from the debtor without the assistance of an attorney or other real estate professional. In his counterclaim against the Wozniaks, the debtor asserts that they failed to pay him $18,000.00 of the agreed purchase price of $27,900.00.

On May 11, 2000, the debtor and the Wozniaks signed a proposal which specified the details for the log home the debtor would build for the Wozniaks.

See Plaintiff's Exhibit W-5. The total price for the log home was $119,338.00, and the debtor orally represented that building the log home might cost less, but the best course of action would be to list the highest price in the contract. According to the Wozniaks, the debtor represented that the Wozniaks' home would serve as a model that prospective purchasers could view and for which the Wozniaks would receive some financial incentive. No prospective log cabin purchasers ever visited the Wozniak home, nor did the Wozniaks ever receive a benefit for agreeing to offer their home as a model.

During the course of constructing the Wozniaks' log home, numerous disputes arose regarding the type of material the debtor installed into the building and the cost of such materials. For instance:

(1) The construction proposal of May 11, 2000, called for the installation of a 13-course brick basement, but the debtor ultimately arranged for a poured concrete basement to be installed instead. The debtor stated that he told the Wozniaks that a poured concrete basement was superior to one of laid bricks and that, once aware of the change, the Wozniaks did not object. The Wozniaks, however, maintained that they did not have prior knowledge of or agree to the change.

(2) The Wozniaks at some point discovered that the debtor was using

some non-Asperline products in their log home. When asked about the matter, the debtor explained that the price of the total log home kit from Asperline was, in his opinion, too high and that he had elected to purchase only logs from Asperline while getting other materials from different vendors. Although the debtor claimed that the Wozniaks knew of and consented to the use of non-Asperline products, the Court finds, by a preponderance of the evidence, that the Wozniaks did not approve the change of materials.

(3) The proposal of May 11, 2000, called for the installation of a sliding-glass door in the lower level of the log home. At some point, the debtor told the Wozniaks that local building code did not permit sliding glass doors to be used in that type of situation, and he had installed French doors as a substitute. According to the Wozniaks, no such prohibition against sliding glass doors exists in their area.

(4) The debtor failed to install the correct size and number of baseboard heaters into their log home.

(5) The debtor stated that if the actual cost of constructing the Wozniaks' log home was less than anticipated, then the debtor would refund the difference to the Wozniaks. The Wozniaks never received any sort of

refund from the debtor.

Throughout the course of these disputes, the Wozniaks repeatedly requested proof of receipts and other documentation from the debtor in order to verify the changes and the costs, and the debtor flatly refused to turn over these financial records until late into the litigation of this case. According to the debtor, he refused to turn over the documentation because his accountant had advised him that he was not required to furnish it to the Wozniaks.

HARGRAVE FACTS

The Hargraves visited the Asperline display facility in Lock Haven, Pennsylvania, in April of 2000 and decided to have an Asperline log home constructed for them in Mercer, Pennsylvania. Staff at Asperline presented the Hargraves with a list of authorized Asperline representatives, and the Hargraves contacted several companies from that list. The debtor's construction company appeared on that list and was among those contacted by the Hargraves. According to testimony by Karen Hargrave, the debtor was the only person willing to construct a log home in the Lake Latonka private community in Mercer. The debtor represented to the Hargraves that he had built more than 80 log cabins, although the Hargraves later learned that such representation was not true.

On August 27, 2000, the Hargraves and the debtor signed an agreement for

the construction of a log home valued at $225,750. The debtor testified that he began work on the site as soon as possible because the Hargraves wanted the construction to be expedited. To that end, the debtor arranged for excavation to take place on the site in early August, before a proposal had been formalized between the parties and before the Hargraves had secured proper financing. *See* Debtor's Exhibit G at 5, 6 (invoices of August 26, 2000, and August 8, 2000, from Coppock, Inc.). The exact time that the excavation work was done is uncertain, as are the true extent and cost of such work. Nevertheless, given the liquidated nature of the debt owed to the Hargraves, these details are immaterial. What is material, however, is that after the Hargraves signed the August 27, 2000, agreement, the debtor unilaterally altered the agreement by adding $23,000 to the contract price, purportedly because of more costly excavation work near the garage. *See* Debtor's Exhibit A at 3. Also relevant is that when the Hargraves had requested a copy of the contract at the time of signing, the debtor claimed that he could not provide them with one because his copier was broken.

As a result of these additional costs and other disputed matters, relations between the debtor and the Hargraves deteriorated throughout the fall and winter of 2000. The Hargraves asked the debtor for invoices and receipts to justify the alleged increased expenditures, but the debtor refused. Again, he claimed that his

accountant had advised him that he did not need to show the Hargraves any such written documentation. In addition, work on the log home hit a snag when the parties discovered that the subcontractors hired by the debtor, U.S. Log Builders, had laid several courses of logs incorrectly. This defect in the log "shell" could not be corrected without stripping off all the logs and beginning anew.

To correct this problem, the debtor contacted an experienced log home contractor by the name of Michael Mullenax in February of 2001 and introduced him to the Hargraves. Mullenax conducted an evaluation on the existing log structure and determined that he could tear down the faulty log courses and reconstruct the house as desired for an additional $38,517.09 on top of the cost originally agreed upon by the debtor and the Hargraves. In other words, Mullenax required that the Hargraves escrow an additional $38,517.09 in order for him to complete the construction. The Hargraves did not want to pay Mullenax's additional fees, and consequently attorneys for all parties became involved.

In late May and early June of 2001, the parties agreed to settle the matters out of court. In a "Settlement Agreement and Release" (Plaintiff's Exhibit # H-5) signed by the Hargraves, the debtor, and Waterfield Financial Corporation – the company that the Hargraves hired to finance the construction, the debtor agreed (i) to provide the $38,517.09 required for Mullenax to complete the construction,

and (ii) to satisfy a debt of $11,450.00 to Mullenax for work that Mullenax had performed in connection with the Hargraves' residence. In exchange for these payments, the Hargraves and Waterfield Financial Corporation agreed to terminate the debtor's liability for the August 27, 2000, construction proposal and "release and forever discharge" any and all causes of action that might have arisen in connection with the construction. Regarding admissions of fault, paragraph 6 of the settlement agreement states that the agreement "is executed as a compromise of disputed claims" and that the debtor's contemplated payments are "not in any manner to be construed as an admission of liability such liability being expressly denied."

At trial, the debtor admitted that he has never paid the $38,517.09 to the Hargraves in accordance with the settlement agreement. He also testified – and Mullenax's testimony corroborated – that he has satisfied the $11,450.00 obligation to Mullenax by providing Mullenax with building equipment and other materials. Accordingly, the Hargraves themselves had to provide the additional $38,517.09 escrow payment needed to finish their house. Mullenax began work on the Hargraves' log house in May of 2001, and the Hargraves moved in after Mullenax had completed the work in October of 2001. Prior to moving into their log home in Mercer, the Hargraves rented the basement of a home belonging to

friends of their family.

On February 1, 2002, the debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code.

LAW

Section 523 addresses exceptions to discharge and provides, in part,

> (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 a fiduciary capacity, embezzlement, or larceny;
>
> * * *
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

11 U.S.C. § 523(a).

DISCUSSION

I. SECTION 523(a)(4)

The discharge exception contained in 11 U.S.C. § 523(a)(4) renders a claim nondischargeable in three situations: fraudulent malfeasance by a fiduciary, embezzlement, and larceny. *See* 4 COLLIERS ON BANKRUPTCY ¶ 523.10[1][c] (15th ed. rev. 2004) (noting that the phrase "while acting in a fiduciary capacity" clearly qualifies the words "fraud or defalcation" and not "embezzlement" or "larceny"). In order for a fiduciary relationship to exist, the debtor must "hold funds in trust for a third party." *R.E. America, Inc. v. Garver* (*In re Garver*), 116 F.3d 176, 179 (6th Cir. 1997) (noting this definition in dicta because parties had previously stipulated to existence of fiduciary relationship). *See Brady v. McAllister* (*In re Brady*), 101 F.3d 1165, 1172-73 (6th Cir. 1996) (noting that term "fiduciary" applies "only to express or technical trusts and does not extend to implied trusts, which are imposed on transactions by operation of law as a matter of equity").

In the case at hand, the plaintiffs provided the debtor with various sums of money in exchange for the debtor's agreement to construct two log homes. None of this money was held in trust for any third party, and the plaintiffs did not present any evidence of an express or technical trust relationship. *See, e.g.*, *In re*

Grim), 293 B.R. at 166 (listing requirements for express trust to exist under Ohio law: intent to create trust, trustee, trust res, and definite beneficiary). In agreeing to construct log homes for the plaintiffs at a set price, the debtor had discretion to allocate the construction money among various costs and expenses, including his personal compensation, as long as he ultimately provided the plaintiffs with log homes that substantially complied with the original contracts. In this respect, the debtor did not hold the plaintiffs' money in trust for any third party and, therefore, did not act as a fiduciary for the purposes of 11 U.S.C. § 523(a)(4).

Nor did the debtor's actions fit within the definition of embezzlement under § 523(a)(4). Federal law defines "embezzlement" under section 523(a)(4) as the "fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." *In re Brady*, 101 F.3d at 1172-73 (internal citations omitted). "A creditor proves embezzlement by showing that he entrusted his property to the debtor, the debtor appropriated the property for a use other than that for which it was entrusted, and the circumstances indicate fraud." *Id*.

Applying that definition to the facts of this case, the Court finds that the debtor did not embezzle the plaintiffs' funds because they did not "entrust" him with funds to which they retained cognizable equitable or legal title. Instead, they

paid him various sums of money in exchange for his promises to construct two log homes. These were simple, contractual exchanges of money for promises. Conceivably, the debtor could have taken all the plaintiffs' money and donated it to a worthwhile charity, and that would have been of no consequence to the plaintiffs as long as the debtor constructed the two log homes as contemplated in the parties' agreements. Therefore, the debtor's use or misuse of funds in these cases cannot be characterized as embezzlement for the purposes of § 523(a)(4).

Finally, the debtor's conduct did not amount to larceny because he lawfully possessed the funds from the plaintiffs and he was to be personally compensated from the same. Larceny for the purposes of § 523(a)(4) is defined as "the fraudulent and wrongful taking and carrying away of the property of another with intent to convert such property to the taker's use without the consent of the owner." *In re Grim*, 293 B.R. at 166. In the present case, the plaintiffs provided the debtor with various amounts of money in exchange for the debtor's agreement to construct two log homes. As such, the debtor's possession and use of the funds was not "fraudulent and wrongful" but rather was overtly contemplated and agreed upon by the parties. The debtor's actions, accordingly, do not fit within the definition of "larceny" that courts have applied in the context of § 523(a)(4).

For these reasons, the Court finds that the plaintiffs' claims against the

debtor are not rendered nondischargeable by 11 U.S.C. § 523(a)(4).

II. SECTION 523(a)(6)

The party contesting the dischargeability of a debt under § 523(a)(6) has the burden of proving, by a preponderance of the evidence, that the debtor's conduct was willful and malicious. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). From the plain language of the statute, the debt must be for an injury that is both willful *and* malicious. *See In re Markowitz,* 190 F.3d 455, 463 (6th Cir. 1999); *In re Trantham,* 304 B.R. 298, 306 (B.A.P. 6th Cir. 2004).

The United States Supreme Court has held that a debt is nondischargeable under 11 U.S.C. § 523(a)(6) if it results from an act with "intent to cause injury." *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998). The Sixth Circuit has held "that unless 'the actor desires to cause consequences of his act, or ... believes that the consequences are substantially certain to result from it' . . . he has not committed a 'willful and malicious injury' as defined under § 523(a)(6)." *In re Markowitz*, 190 F.3d at 464 (quoting RESTATEMENT (SECOND) OF TORTS § 8A, at 15 (1964)). *Accord In re Kennedy*, 249 F.3d 576, 580 (6th Cir. 2001).

"Malicious" for purposes of § 523(a)(6) is said to occur when a person acts "in conscious disregard of one's duties or without just cause or excuse; it does not require ill-will or specific intent to do harm." *In re Trantham,* 304 B.R. at 308,

quoting Wheeler v. Laudani, 783 F.2d 610, 615 (6th Cir. 1986).

Whether a debtor acted both willfully and maliciously requires an examination of the debtor's state of mind at the time of the incident. "However, as a debtor will rarely, if ever, admit to acting in a willful and malicious manner for purposes of § 523(a)(6), both requirements can be inferred through the circumstances surrounding the injury at issue." *In re Sintobin*, 253 B.R. 826, 831 (Bankr. N.D. Ohio 2000). *See also In re Sullivan,* 238 B.R. 230, 238 n.15 (Bankr. D. Mass. 1999) (showing of a debtor's intent must necessarily be made through circumstantial evidence for willful and malicious injury discharge exception); *In re Hanes*, 214 B.R. 786, 822 (Bankr. E.D. Va. 1997)(implied malice may be shown by the acts or conduct of the debtor in the context of his surrounding circumstances).

In accordance with the definitions above, the Court finds that the plaintiffs have failed to establish, by a preponderance of the evidence, that the debtor's conduct was both willful and malicious. For example, while the debtor may have intentionally misrepresented his expertise in constructing log homes in order to induce the parties to contract with him, the Court finds that, at least at the time of contracting, the debtor hoped to complete the contracts successfully. In addition, none of debtor's conduct described at trial or through the parties' briefing could be

described as "malicious." As noted above, negligently or recklessly inflicted injuries do not constitute nondischargeable debts under § 523(a)(6). *See* 523 U.S. at 62-63. Therefore, the Court holds that the plaintiffs have not provided evidence sufficient to sustain a finding of nondischargeability under § 523(a)(6).

III. SECTION 523(a)(2)(A)

In order to establish that a debt is nondischargeable under § 523(a)(2)(A), a creditor must prove the following elements by a preponderance of the evidence: (1) the debtor obtained money through a material representation 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 loss. *See Rembert v. AT & T Universal Card Servs., Inc., (In re Rembert)*, 141 F.3d 277, 280-81 (6th Cir. 1998), *cert. denied,* 525 U.S. 978 (1998).

In order to except a debt from discharge, a creditor must prove each element of § 523(a)(2)(A) by a preponderance of the evidence. *See Grogan v. Garner,* 498 U.S. 279 (1991). "The burden of showing something by a preponderance of the evidence . . . simply requires the trier of fact to believe that the existence of a fact is more probable than its nonexistence before [he] may find in favor of the party who has the burden to persuade the [judge] of the fact's existence." *Concrete*

Pipe & Products of Cal., Inc. v. Construction Laborers Pension Trust for Southern Cal., 508 U.S. 602, 622 (1993) (internal quotation marks omitted).

A. ADV. NO. 02-1247 – WOZNIAKS

Having heard testimony from the parties and after having reviewed the evidence submitted, the Court finds that the Wozniaks have not met their evidentiary burden to show justifiable reliance on false representations or to show that such reliance was a proximate cause to a pecuniary loss. Unlike the Hargraves' situation, the Wozniaks' alleged claim against the debtor is presently unliquidated or, in other words, not reduced to a specific dollar amount. This requires the Court to apply every element of § 523(a)(2)(A) to the facts at hand without the benefit of a written agreement or compromise between the parties.

ELEMENT 1: The debtor obtained money through a material representation that, at the time, the debtor knew was false or made with gross recklessness as to its truth. The misrepresentations that are of consequence for these proceedings are those misrepresentations made at the time of contracting. In that respect, the evidence showed that the debtor seriously misrepresented his level of experience building log homes when he solicited the Wozniaks' business. Even though he had yet to complete construction on a single log home, the debtor told the Wozniaks that he had built over 60 and even referred to his company as "log cabin

specialists" on his calling card and in company letterhead. The debtor knew these representations to be false when he made them.

However, the Wozniaks did not present evidence that, at the time of signing the contract, the debtor misrepresented his intentions, for instance, to construct their log home with all Asperline products, to install a brick-course basement, or to build a sliding glass door into the lower level. Although the debtor did not ultimately follow through and perform these and other parts of the contract, the Wozniaks have failed to establish, by a preponderance of the evidence, that the debtor did not intend to honor the terms of the contract when he signed it. The debtor's breaches that occurred during the performance of the Wozniaks' contract may have been intentional, but they do not amount to fraud.

ELEMENT 2: The debtor intended to deceive the creditor. While the Wozniaks proved that the debtor clearly intended to deceive them about his level of experience, the Wozniaks did not show that the debtor, at the time of contracting, intended to deceive them regarding specific aspects of the construction. Rather, he intentionally chose to breach certain aspects of the contract only after he had started construction on the home. These intentional breaches of contract do not give rise to the type of claim that is rendered nondischargeable under § 523(a)(2)(A).

ELEMENT 3: The creditor justifiably relied on the false representation. Although the Wozniaks justifiably relied on the debtor's representation that he had considerable experience building log homes, they did not justifiably rely on other misrepresentations. For example, the Wozniaks' reliance on the debtor's oral representation that they would receive money back if construction of their home cost less than expected was not justifiable where such representation was not reduced to writing. Moreover, a home owner cannot justifiably expect a contractor to build a home without the contractor at least anticipating to make some profit. Thus, to the extent the debtor orally misrepresented his intent to refund money to the Wozniaks or build their home at cost, the Wozniaks could not have justifiably relied on such representations.

ELEMENT 4: The creditor's reliance was the proximate cause of loss. The Wozniaks failed to show that their reliance on the debtor's misrepresentation regarding his experience – or any of his misrepresentations for that matter – resulted in a pecuniary loss to them. While the Wozniaks might not have contracted with the debtor had they known of his considerable lack of experience, they did not show that a more experienced builder would have avoided the problems they encountered (*i.e.*, the poured concrete basement instead of the course block basement, the non-Asperline products, etc.). *See, e.g.*, *Miller v.*

Bauer (*In re Bauer*), 290 B.R. 568, 579 (Bankr. S.D. Ohio 2003) (noting that proximate causation is "demonstrated by conduct that is a substantial factor in the loss, or where the loss may reasonably be expected to follow"). The Court afforded the Wozniaks ample opportunity to introduce expert testimony via the Court's scheduling order of May 21, 2003 (Docket # 16), but the Wozniaks did not produce such testimony.

The Wozniaks appear to have received, for the price they agreed upon, a log home that substantially complies with their written contract. Even though the debtor may have intentionally breached the contract by installing a different type of basement, doors, and other building materials, the evidence adduced at trial failed to establish that any of these changes reduced the value or functionality of the Wozniaks' home. Simply put, the Court is not persuaded (i) that the Wozniaks have suffered an out-of-pocket loss as a result of the debtor's misrepresentations, and (ii) that a proximate cause relationship exists between the debtor's misrepresentations and an alleged pecuniary loss. Therefore, the Court finds that the Wozniaks' claim against the debtor is not rendered nondischargeable by 11 U.S.C. § 523(a)(2)(A).

DEBTOR'S COUNTERCLAIM AGAINST THE WOZNIAKS

In his counterclaim, the debtor asserts that the Wozniaks failed to pay him $18,000.00 of the agreed purchase price of $27,900.00 for the land on which the Wozniaks' log home was built. The debtor attempted to introduce oral testimony regarding the Wozniaks' alleged obligation, but plaintiffs' counsel objected based upon the Ohio Statute of Frauds. *See generally* OHIO REV. CODE. ANN. § 1335.05 (Anderson 2004).[2] Because the debtor had no written evidence to substantiate the sale of land between the parties, plaintiffs' objection was sustained. The debtor did not introduce any other evidence to support his counterclaim. Given this lack of admissible evidence, the Court finds in favor of the Wozniaks and against the debtor with respect to the debtor's counterclaim.

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[2] The Statute of Frauds, among other matters, mandates that contracts for the sale of real property must be in writing in order to be enforceable:

> No action shall be brought whereby to charge the defendant, upon a special promise, to answer for the debt, default, or miscarriage of another person; nor to charge an executor or administrator upon a special promise to answer damages out of his own estate; nor to charge a person upon an agreement made upon consideration of marriage, or upon a contract or sale of lands, tenements, or hereditaments, or interest in or concerning them, or upon an agreement that is not to be performed within one year from the making thereof; unless the agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged therewith or some other person thereunto by him or her lawfully authorized. [. . . .]

OHIO REV. CODE. ANN. § 1335.05 (Anderson 2004).

B. ADV. NO. 02-1248 – HARGRAVES

The Court finds that the $38,517.09 debt owed by the debtor to the Hargraves by virtue of the "Settlement Agreement and Release" dated June 22, 2001, (Plaintiff's Exhibit H-5) is a nondischargeable debt pursuant to 11 U.S.C. § 523(a)(2)(A). This finding is at odds with the finding from the Wozniaks' case because the Hargraves have a written settlement agreement with the debtor that both (i) specifies a fixed amount of damages for all claims stemming from the contract to build the Hargraves' log home, and (ii) simplifies the inquiry that the Court needs to conduct regarding the alleged fraud. This Court need only ascertain whether the settlement reflects a valid claim for fraud in order to find the debt nondischargeable.

This Court's ruling on this matter is governed by the recent decision of the United States Supreme Court in the case of *Archer v. Warner*, 538 U.S. 314 (2003). In *Archer*, the court decided that a debt resulting from a settlement agreement will be deemed nondischargeable in a Chapter 7 bankruptcy if the settlement debt arose out of "false pretenses, a false representation, or actual fraud." 538 U.S. at 323 (quoting language from 11 U.S.C. § 523(a)(2)(A)). In so deciding, the Court held that a valid settlement agreement did not preclude a party from showing that the agreement arose out of an "underlying fraud" claim and that

such claim became "embodied" in the settlement agreement, thereby making the settlement debt nondischargeable. 538 U.S. at 322. Applying that holding to the facts of the Hargraves' case, this Court must determine whether underlying nature of the debt embodied in the settlement agreement constituted "false pretenses, a false representation, or actual fraud" within the meaning of Section 523(a)(2)(A). In making these determinations, the Court will apply the elements for fraud as detailed in *In re Rembert.* 141 F.3d at 280-81.

ELEMENT 1: The debtor obtained money through a material representation that, at the time, the debtor knew was false or made with gross recklessness as to its truth. The debtor seriously misrepresented his level of experience building log homes when he first met with the Hargraves, and because the Hargraves did not know the debtor's true level of experience, those representations weighed heavily in the their decision to contract with the debtor. The debtor told the Hargraves that he had constructed more than 80 log homes. He knew this representation to be false when he made it because, although he did have experience constructing conventional "stick frame" homes and even doing work on existing log homes, his nascent construction company of "log cabin specialists" had yet to build even one log home from start to finish.

ELEMENT 2: The debtor intended to deceive the creditor. The debtor, no

doubt, intended to deceive the Hargraves about his lack of experience because he did not want to risk losing their business by admitting that he had never constructed a log home completely. The Hargraves would have likely had significant reservations about hiring an inexperienced builder like the debtor to construct their $225,000 log home, a structure that was to serve as their primary residence. Admitting to a considerable lack of experience, if it did not thwart negotiations altogether, might have forced the debtor to accept a reduction in price in order to compensate the Hargraves for the risks associated with hiring an inexperienced builder. To avoid these dangers, the debtor intentionally misled the Hargraves.

ELEMENT 3: The creditor justifiably relied on the false representation. The Court finds several reasons why the Hargraves justifiably relied on the debtor's false representations about his level of experience. First, Asperline Log Homes forwarded the debtor's name, along with the names of other approved builders, to the Hargraves after they had inquired about purchasing an Asperline home. The Hargraves had no reason to suspect that any builder recommended by Asperline would have little or no experience constructing log homes. Second, the debtor's company letterhead and other correspondence describe Nadolski Builders as "log cabin specialists." While the term "log cabin specialist" does not denote

official certification or licensure, its prominent placement throughout the company's literature suggests that the term is more than mere sales puffery. A prospective purchaser of a log home could justifiably rely on the term when deciding whether to hire a certain builder to construct a log home. For these reasons, the Court finds that the Hargraves did in fact justifiably rely on the debtor's representations regarding his level of experience.

ELEMENT 4: The creditor's reliance was the proximate cause of loss.

The Court finds that the parties' settlement agreement embodies a recognition that Hargraves' pecuniary loss was proximately caused by the debtor's misrepresentations about his level of experience. Specifically, the evidence at trial showed that the debtor hired a company, U.S. Log Builders, to lay the log foundation for the Hargraves' home and that company failed to install the log courses properly. To correct the problem, a different construction manager, Michael Mullenax, had to tear out the faulty log courses and start anew. Mullenax's repair and construction work cost the Hargraves an extra $38,517.09 on top of the $225,750 they had originally agreed to pay for the construction of their log home.

In order to resolve the dispute over liability for these and other construction problems, the debtor and the Hargraves entered into a settlement agreement

wherein, among other matters, the debtor agreed to provide the Hargraves with $38,517.09 to correct the construction shortfall. When the debtor defaulted on that portion of the agreement, the Hargraves had to provide the money with their own resources.

Proximate causation, for the purposes of 11 U.S.C. § 523(a)(2)(A), is shown by "conduct that is a substantial factor in the loss, or where the loss may be reasonably expected to follow." *Miller v. Bauer* (*In re Bauer*), 290 B.R. 568, 579 (Bankr. S.D. Ohio 2003). By hiring a builder like the debtor – who had never fully constructed a log home – rather than hiring an experienced builder, the Hargraves unknowingly faced an increased risk of faulty construction and poor workmanship. In fact, those very problems arose when the debtor hired U.S. Log Builders to lay the log courses, the courses were installed incorrectly, and the Hargraves had to hire an experienced builder to complete construction. These facts illustrate how an experienced log builder avoided the problems that the debtor encountered while constructing the Hargraves' log home. Thus, the Hargraves' extra payment of $38,517.09 constitutes a pecuniary loss that arose out of, and was proximately caused by, the debtor's fraudulent misrepresentations.

The parties' settlement agreement resolved all claims and causes of action stemming from the debtor's contract to build the Hargraves' log home. The

Hargraves' underlying claim against the debtor for fraud, then, became embodied in the settlement agreement, along with the Hargraves' other claims, for breach of contract and otherwise. While some of this $38,517.09 claim might include damages for breach of contract and other costs not directly associated with remedying the debtor's tortious conduct, all the $38,517.09 is rendered nondischargeable because the debt arose, at least in part, from the debtor's fraud upon the Hargraves. *See generally Cohen v. De La Cruz*, 523 U.S. 213, 218-19 (1998) ("Once it is established that specific money or property has been obtained by fraud, . . . 'any debt' arising therefrom is excepted from discharge.") (quoting language from 11 U.S.C. § 523(a)(2)(A)); 523 U.S. at 223 (holding that nondischargeable debt under 11 U.S.C. § 523(a)(2)(A) "encompasses any liability arising from money, property, etc., that is fraudulently obtained, including treble damages, attorney's fees, and other relief that may exceed the value obtained by the debtor"). Thus, the Hargraves' entire claim against the debtor for $38,517.09 is nondischargeable.

For the aforementioned reasons, the Court finds that Hargraves' claim against the debtor for $38,517.09 as created by the "Settlement Agreement and Release" dated June 22, 2001, (Plaintiff's Exhibit H-5) arose out of an underlying claim for fraud and that such claim became embodied in the parties' settlement

agreement, thereby making the settlement debt nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A).

ADDITIONAL COMMENT

Given the similar way in which the debtor misrepresented his log home building expertise to both sets of plaintiffs, it may seem inconsistent for only the Hargraves' debt to be deemed nondischargeable. Certainly, it is understandable for the Wozniaks to feel disappointed, given the frustrations they experienced with the construction of their log home. Unlike the Hargraves, however, the Wozniaks did not have a liquidated claim against the debtor. With the Hargraves, it was conceded that the debtor owed them the liquidated sum of $38,517.09. All the Court needed to decide was whether the agreed debt was nondischargeable under Section 523(a)(2)(A). With the Wozniaks, however, their claims, either sounding in tort or breach of contract, were unliquidated. There was no agreement that the debtor owed the Wozniaks anything, let alone an agreed sum of money. In addition, the Wozniaks, unlike the Hargraves, essentially received what they bargained for – a log home – at the price provided under their written agreement with the debtor. To the extent that some of the details were not what the Wozniaks expected, the Wozniaks have failed to establish, by a preponderance of the evidence, that these inconsistencies were proximately caused by the debtor's

misrepresentations or that they suffered anything other than nominal damages as a result.

CONCLUSION

For the foregoing reasons, the $38,517.09 debt owed by the debtor to the Hargraves is a nondischargeable debt pursuant to 11 U.S.C. § 523(a)(2)(A), and any alleged debt resulting from the debtor's construction of the Wozniaks' log home is a dischargeable debt. With respect to the debtor's counterclaim against the Wozniaks, the Court finds in favor of the Wozniaks and against the debtor. Each party shall bear its own costs and attorneys fees. A separate judgment shall be issued for each adversary proceeding.

IT IS SO ORDERED.

/s/ Arthur I. Harris 05/11/2004
Arthur I. Harris
U.S. Bankruptcy Judge