

Grounds for Pursing and/or Preventing a Contractor from Escaping Liability in Bankruptcy Court for Its Fraudulent or Wilful and Malicious Conduct on a Construction Project.

While most Bankruptcies may be filed for legitimate reasons by persons in genuine financial distress beyond their own control, others use Bankruptcy to try to escape liability for their own fraud or misconduct.

Sometimes, unfortunately, many homeowners and other victims of a fraudulent or dishonest contractor, and even their attorneys, simply “give up” when they learn of a Bankruptcy filing by a wrongdoer.

While the Bankruptcy filing does automatically stop or “*stay*”, at least temporarily, most lawsuits against the wrongdoing contractor or “*debtor*”, that is NOT necessarily the end of your right to pursue a claim for damages.

The debtor may still have known assets to pay all or part of your claim, so timely filing and pursuing your claims in Bankruptcy Court - with the aid of a Bankruptcy attorney - may yield at least some money.

Additionally, if the Bankrupt contractor had Liability Insurance which might cover the defective construction or other personal injury or property damage caused by the contractor, the Bankruptcy filing does not relieve the debtor’s insurer from the obligation to defend the case and to pay valid claims covered by that policy or those policies.

And if the debtor has Fraudulently Transferred or attempted to hide its assets from creditors, the Bankruptcy trustee may be willing to file an adversary action in the Bankruptcy Court to try to recover some or all of those assets from the persons to whom they were fraudulently transferred, for the benefit of the creditors of the Bankrupt debtor.

Further, even if relief is not otherwise available under any of these provisions, it may be possible under 11 U.S.C. § 523 for your Bankruptcy attorney to initiate an adversary proceeding in the Bankruptcy Court to deny the debtor a discharge for its “fraudulent” or “wilful and malicious” conduct by the debtor contractor, or also on several other grounds.

If successful in such a proceeding, you could still pursue the debtor indefinitely on your claims, even if it otherwise receives a discharge of all its other debts!!

Numerous Court decisions hold that fraud by a contractor in inducing a party to enter into a contract or agreement, such as misrepresentations as to a contractor's qualifications or experience or license status, or grossly fraudulent promises, may be grounds to deny the debtor the ability to discharge its debt to the defrauded parties.

To prevail on a non-dischargability action for fraud under section 11 U.S.C 523(a)(2)(A), a creditor must demonstrate five elements:

- (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor;
- (2) knowledge by the debtor of the falsity or deceptiveness of his statement or conduct;
- (3) an intent to deceive;
- (4) justifiable reliance by the creditor on the debtor's statement or conduct; and
- (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct.

Oney v. Weinberg (In re Weinberg) (9th Cir. BAP 2009) 410 B.R. 19, 35 (citing *Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman)* (9th Cir. 2000) 234 F.3d 1081, 1085; *Deitz v. Ford (In re Deitz)* (9th Cir. 2014) 760 F.3d 1038, 1050.

Thus, if you would not have entered into the contract or agreement but for or without this fraud, the contractor's debt to you for your damages may be found to be not dischargeable.

Also, where a contractor has wilfully and maliciously or fraudulently induced a property owner to pay unearned money or money for defective and substandard work, or has requested and received payments while failing to complete the work as contracted for, or has received payments for work not done, or has diverted or "converted" payments made for construction work away to personal or other uses without completing the work paid for, thus causing damages due to incomplete, defective and/or substandard construction, numerous Bankruptcy law case precedents find that such conduct may constitute "*willful and malicious injury*" under 11 U.S.C § 523(a)(6), and thus your claims may still be pursued after the Bankruptcy proceedings, even if that conduct arises out of an otherwise ordinary construction contract.

'[A] malicious injury requires (1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse. In re Bammer, 131

F.3d 788, 791 (9th Cir. 1997) (en banc).

“90. Under California Civil Code Section 1572, a party to a contract with the intent to deceive another party to the contract, or to induce the other party to enter into the contract, acts with malice causing injury. In re Martinez, supra.

“91. The Court concludes that Defendant fraudulently induced Plaintiffs to enter into the Contract at a time when he knew he was not licensed. Based upon his prior acts, as the Court notes above, the Defendant had to have believed that injury to the Plaintiffs was substantially likely to occur based upon his actions and/or inaction. Defendant further deceived Plaintiffs into making progress payments with continued misrepresentations about the status of the work on Plaintiffs' home and did so for his own gain to obtain funds from Plaintiffs. This evidences a "subjective motive" by Defendant certain to inflict injury. The funds that Plaintiffs provided to Defendant were substantial and the injury that was caused was certainly foreseeable. The Court concludes that the malicious prong as set forth in In re Jercich, supra, is satisfied. Additionally, the Court concludes based upon the later emails between the parties, that Defendant was seeking an exit strategy without intending to complete construction of the home as agreed upon in the Contract between Plaintiffs and Defendant. These acts constitute a willful and malicious injury pursuant to 11 U.S.C. Section 523(a)(6).”(Emphasis added)

Ford v. Deitz (In re Deitz) (Bankr. E.D. Cal. July 28, 2011) 2011 Bankr. LEXIS 5563, *62-64, 2011 WL 10637551; *aff'd, Deitz v. Ford (In re Deitz)* (B.A.P. 9th Cir. 2012) 469 B.R. 11, 25-26.

Thus, where a contractor deliberately and intentionally fails to competently complete a job, but has requested and obtained money or payments for past for construction work and then converted or spent the money on things other than the uses or purposes for which the payments were requested and paid, and not on the construction work contracted and paid for, those facts state a non-dischargability claim under 11 U.S.C. § 523(a)(6).

“[T]he court finds that the Defendants' actions in failing to supervise the job, failing to pay the subcontractors, misrepresenting to Plaintiffs that the subcontractors were paid in full in order to obtain additional funds from Plaintiffs, in failing to complete the job and in using the construction funds for his own benefit were "willful", in that they were done deliberately and intentionally. The court finds Defendant's actions "malicious" pursuant to its meaning in section 523(a)(6) as they were done in conscious disregard of his obligations under the contract, and without just cause or excuse.” (Emphasis added)

Hanson v. Kelly (In re Kelly) (Bankr. S.D. Tex. 2008) 385 B.R. 877, 882-884.

“To satisfy the "willful injury" requirement of § 523(a)(6) a plaintiff must demonstrate that

"the debtor had a subjective motive to inflict the injury;" or "that the debtor believed the injury was substantially certain to occur as a result of the debtor's conduct." *Petralia v. Jercich*, (In re Jercich), 238 F. 3d 1202, 1208 (9th Cir. 2001)."

"The requirement of "malicious injury" is separate from the requirement of "willful." *Carrillo v. Su* (In re Su), 290 F.3d 1140, 1146 (9th Cir. 2002). "A malicious injury involves (1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse." *Jercich* at 1208 quoting *In re Bammer*, 131 F.3d 788, 791 (9th Cir. 1997)(en banc).

"Actual fraud, pursuant to Cal. Civ. Code § 1572, may be committed by a party to the contract with intent to deceive another party to the contract, or to induce the other party to enter the contract. The acts may include "(1) [t]he suggestion of a fact, of that which is not true by one who believes it is not true;... (4) [a] promise made without any intention of performing it;... (5) [o]r any other act fitted to deceive." *Id.*

"I find that Mr. Martinez fraudulently induced Mr. and Mrs. Torres to enter into a sham contract by stating that he was a licensed contractor when he knew that was not true, and he believed that the injury to Mr. and Mrs. Torres was substantially likely to occur based upon his actions.

"Mr. Martinez deceived Mr. and Mrs. Torres into making progress payments by his misrepresentations about the state of the Project, and although he did so for his own gain rather than with intent to hurt them, injury to Mr. and Mrs. Torres from the loss of their funds was a substantial and foreseeable certainty. The malicious prong of the test as set forth in *Jercich* is satisfied. Additionally, the evidence supports a finding that Mr. Martinez had no intention to perform to completion the contract as agreed upon, and that he performed only a portion of the work on the Project. The foregoing constitutes a willful and malicious injury pursuant to § 523(a)(6)."

"Conversion of the property of another also constitutes a "willful and malicious injury within the meaning of § 523(a)(6). *Del Bino v. Bailey* (In re Bailey), 197 F. 3d 997, 1000 (9th Cir. 1997). *Mendoza v. Continental Sales, Co.*, 140 Cal. App. 4th 1395, 45 Cal. Rptr.3d 525 (Cal. Ct. App. 2006) defined conversion as follows:

"Conversion is the wrongful exercise of dominion over the property of another. The elements of a conversion claim are: (1) the plaintiff's ownership or right to possession of the property; (2) the defendant's conversion by a wrongful act or disposition of property right; and damages. Conversion is a strict liability tort. The foundation of the action rests neither in the knowledge or intent of the defendant. *Mendoza*, 140 Cal. App. 4th at 1405 quoting *Burlesci v. Petersen*, 68 Cal. App. 4th 1062, 1066, 80 Cal. Rptr. 2d 704 (1998).

"Money is subject to a action for conversion "if a specific sum capable of identification is involved." *Farmers Ins. Exchange v. Zerlin*, 53 Cal. App. 4th 445, 451, 61 Cal. Rptr. 2d 707 (Cal. Ct. App. 1997) citing *Weiss v. Marcus*, 51 Cal. App.3d 590, 599, 124 Cal. Rptr. 297

(Cal. Ct. App. 1975).”

In this case, the specific amount of funds which Mr. and Mrs. Torres gave to Mr. Martinez is established as \$ 93,000. At the time Mr. Martinez obtained the funds and diverted them to other uses, Mr. and Mrs. Torres had the right to possession of those funds. Mr. Martinez converted the funds for his own purposes and failed to use the funds for the Project. Mr. and Mrs. Torres have satisfied the requirement of a willful and malicious injury. Accordingly, I also find the debt nondischargeable pursuant to § 523(a)(6)”(Emphasis added)

Torres v. Martinez (In re Martinez) (Bankr. C.D. Cal. Feb. 26, 2008) 2008 Bankr. LEXIS 470,

*18-23, 49 Bankr. Ct. Dec. 173 .

“From the moment he began spending Stephens's money on expenses other than for the job, he had to have known, with substantial certainty, that he was misappropriating Stephens's funds for his own use. Morrison was tardy in starting labor on the job even though he agreed to complete the work in 3 months. The job then dragged on for over a year and, at the conclusion of that time, the job was only 30% finished. Assuming for the sake of argument that Morrison had completed the job, the \$37,867.84 he had already spent fully paid for all the supplies he would need, and the \$20,359.91 he paid to laborers would have covered all his third-party labor expenses, then the remaining \$70,642.25 in Stephens's money would have gone to Morrison for his labor. If the job was only 30% completed at the time Moore took over the job, then the most Morrison would have been entitled to would have been 21,192.68. And, in order to even make that finding, Morrison would have had to present some evidence to this Court to substantiate his entitlement to that amount.”

“All of this evidence also indicates that Morrison acted maliciously in spending a large portion of Stephens's money on his personal expenses. The exhibits and testimony clearly demonstrate that Morrison had not earned most of the money he used for his personal expenses. At the time of entering into the contract with Stephens, Morrison was clearly aware of what tasks he had been hired to complete and the enormity of the job. The contract very clearly set forth what Morrison agreed to do in exchange for the \$128,871 Stephens paid him. When he failed to work on the project and then spent Stephens's money on his personal expenses, he acted in conscious disregard of his duties without just cause or excuse. This conclusion is further bolstered by the fact that Morrison spent a good portion of Stephens's money on his personal expenses prior to even beginning work on the job.”

Stephens v. Morrison (In re Morrison) (Bankr. W.D. Tenn. 2011) 450 B.R. 734, 751-754; *Sinha v.*

Clark (In re Clark) (Bankr. C.D. Ill. 2005) 330 B.R. 702, 707-708.

“[H]owever, with respect to the first element of embezzlement, the court concludes that the Plaintiffs adequately alleged that they entrusted their earnest money to the Defendant as the builder to pay for the construction of the house. They further contend that he used the funds

for a purpose other than construction of their residence and have provided citations to the Defendant's deposition testimony suggesting that the Defendant commingled funds from NCE and Deck Masters. The court further finds that, with respect to the third element of circumstances indicating fraud, the Plaintiffs have alleged enough facts to suggest that the Defendant took their earnest money with knowledge that he had no intention of using those funds to pay for the construction of the residence. Thus, the court concludes that the Plaintiffs have adequately alleged circumstantial evidence of a scheme of deceit indicating fraud or intentional wrongdoing, as required by Rule 9. For these reasons, the court will DENY the Defendant's motion to dismiss the Plaintiffs' Section 523(a)(4) claim with respect to embezzlement.”

.....
“Further, if the Defendant induced the Plaintiffs to give him earnest money personally that he never intended to use on the construction of their residence and was deliberately ignoring their requests pursuant to the Agreement, such conduct could rise to the level of an intentional injury to Plaintiffs' legal rights without just cause or excuse. The Plaintiffs have further alleged that they were harmed by the Defendant's conduct. Therefore, the court concludes that it will deny the motion to dismiss the Plaintiffs' Section 523(a)(6) claim.” (Emphasis added)

Rice v. Morse (In re Morse) (Bankr. E.D. Tenn. 2014) 504 B.R. 462, 472-473, 476.

“Although Mr. Clark did some construction work at the Sinha home, the work was done only to create the appearance that Mr. Clark was honoring his contractual obligations. Dennis Eldridge the contractor hired by the Sinhas to complete the project after the termination of the contract with Mr. Clark -- found that the work done by Mr. Clark clearly showed that Mr. Clark had no intention of completing the job. Mr. Eldridge found problems with the rafters, the chimney, and the framing, which indicated that Mr. Clark was just doing something to look like something was being done”(Emphasis added)

Sinha v. Clark (In re Clark) (Bankr. C.D. Ill. 2005) 330 B.R. 702, 705.

However, obtaining relief against a Bankrupt contractor or other debtor will not necessarily be automatic or easy, or come without at least some further legal proceedings and perhaps a trial in the Bankruptcy Court, or in the Superior Court.

To avoid losing your rights under the Bankruptcy Code, including all of those discussed above, **IMMEDIATELY consult with a specialist Bankruptcy Lawyer to file the required Bankruptcy Court papers and to initiate appropriate proceedings in Bankruptcy Court,** or have your personal attorney do so, **promptly** upon learning that a defendant or a potential defendant has filed any type of proceeding for relief under U.S. Bankruptcy Law!!!

N.B. The contents of this Article **DO NOT** constitute legal advice or create an attorney-client relationship, and **you may NOT rely on them** without seeking legal advice regarding your particular situation and construction contract or claims from a competent Bankruptcy law attorney.

Please also note that statutes, regulations and case law are frequently changing and these materials may now be or may become outdated.

For further information on this topic and how the current law may apply to your case, proceeding and issues, Contact Us via email, phone (415)788-1881 or visit our website at www.wolfflaw.com for other contract information.

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