

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF TENNESSEE

*In re*

PAUL HAROLD MARSH d/b/a  
MARSH CONSTRUCTION CO.  
and JULIA H. MARSH,  
  
Debtors.

No. 94-32867  
Chapter 7

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CHICAGO TITLE INSURANCE CO.,  
ASSIGNEE OF YARBER CARPET  
SALES & SERVICE and MARVIN  
H. WHORLEY and SUSAN G.  
WHORLEY,

Plaintiff,

v.

Adv. Pro. No. 95-3027

PAUL HAROLD MARSH d/b/a  
MARSH CONSTRUCTION CO.,  
  
Defendant.

M E M O R A N D U M

APPEARANCES :

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**MARCIA PHILLIPS PARSONS**  
**UNITED STATES BANKRUPTCY JUDGE**

This case involves the question of whether a debt owed by the debtor, Paul Harold Marsh d/b/a Marsh Construction Co., is nondischargeable under 11 U.S.C. § 523(a)(2)(A). Plaintiff, Chicago Title Insurance Co., seeks such a determination concerning the indebtedness as the assignee of Yarber Carpet Sales & Service and Marvin and Susan Whorley. A trial was held in this adversary proceeding on November 13, 1995. The following sets forth the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I).

I.

The debt in question arises out of the construction and sale of a house by the debtor to Marvin and Susan Whorley (the "Whorleys"), and the debtor's failure to pay Yarber Carpet Sales & Service ("Yarber") for the floor coverings which were installed in the house. Debtor Paul Marsh is a residential general contractor in Tennessee, having been in the business for almost 30 years. On September 7, 1990, the Whorleys and Mr. Marsh entered into a real estate sales contract for the construction and purchase of a new house located at 704 Battlefront Trail, Knoxville, Tennessee, for a total purchase price of \$199,000.00. A two-page addendum to the sales contract

provided that the purchase price included a carpet allowance of \$15.00 per square yard, a vinyl allowance of \$12.00 per square yard and a foyer hardwood allowance of \$6.00 per square foot. It was undisputed that at the time the contract was executed, the parties contemplated that Mr. Marsh would be responsible for payment of the floor coverings in accordance with the terms of the sales contract. Mrs. Whorley testified that this practice conformed with her experience in her two previous home purchases wherein she selected the flooring and the builder thereafter paid the carpet supplier.

Sometime during the construction of the house, Mrs. Whorley asked Mr. Marsh where she should go to select the floor coverings for the house and Mr. Marsh suggested Yarber or Frazier Flooring, Inc. in Knoxville. Mrs. Whorley testified that she telephoned both Yarber and Frazier Flooring and, upon learning that Yarber was open after normal business hours, went to Yarber and made her selections. Because the floor coverings she chose exceeded the contracted allowances, Mrs. Whorley subsequently contacted Mr. Marsh and asked him to advise her of the amount by which she had exceeded the allowances so she could pay him the difference at closing. Mrs. Whorley testified that she had similarly exceeded the allowances in her two previous home purchases and in both instances had paid the builder the

difference at closing.

Contrary to Mrs. Whorley's testimony, Mr. Marsh testified that after the Whorleys made their flooring selections, Mr. Whorley telephoned him and informed him that because they had exceeded the allowances, they would take care of the Yarber bill themselves. Mr. Marsh stated that he agreed to the change and told Mr. Whorley to go ahead and deal with Yarber and he would give them a credit at closing for the contract allowances. Mr. Marsh further testified that several days before the closing, Mr. Whorley called him back and informed him that they had changed their minds and that they no longer desired to pay for the carpet directly. Mr. Whorley denied that he had either of these telephone conversations with Mr. Marsh or that, at any time, he had done or said anything which would lead Mr. Marsh to believe that the Whorleys would be paying Yarber. Both Mr. and Mrs. Whorley testified that it was always understood that Mr. Marsh would be responsible for the cost of the floor coverings.

Mrs. Whorley testified that while she was at the business showroom, she was advised by a Yarber salesperson that Yarber had previously experienced problems with Mr. Marsh failing to pay for carpet installed in houses that he built and that on one occasion, Yarber had to place a lien upon the house to collect payment. Concerned by this information, Mrs. Whorley telephoned

the mortgage company with whom she had been dealing and inquired if anything could be done to insure that the floor coverings installed in her house would be paid so that liens would not be placed on the property. After consulting with the title company, the mortgage company advised Mrs. Whorley that if the builder executed and filed a notice of completion, the Whorleys as purchasers would be protected.

On November 9, 1990, at the request of East Tennessee Title Insurance Agency, the closing agent for the parties, Mr. Marsh executed a Notice of Completion which recited that construction of the house located at 704 Battlefront Trail was completed on November 9, 1990. Despite this representation, the carpet and other floor coverings had not yet been placed in the house and were not installed until three days later on November 12, 1990.

The closing on the purchase of the house was held November 21, 1990, at the offices of East Tennessee Title Ins. Agency. Mrs. Whorley testified that on the morning of the closing, she and Mr. Whorley and Mr. Marsh walked through the house to insure that their "punchlist" of last minute details on the house had been completed. According to Mrs. Whorley, Mr. Marsh had in his possession at the walk-through the invoices from Yarber which set forth the total owed for the floor coverings. Mrs. Whorley testified that Mr. Marsh advised them that there was an error in

the invoices and then telephoned Yarber in the Whorleys' presence to inform Yarber of the error. Mrs. Whorley stated that while on the phone, Mr. Marsh obtained the corrected numbers from Yarber's and then based on this information, prepared for the Whorleys a "Settlement of Extra Charges" which listed the various amounts totaling \$2,329.85 by which the Whorleys had exceeded their flooring allowances.

At the closing, Mr. Marsh signed and delivered a warranty deed conveying the property to the Whorleys, receiving in exchange a check for \$19,233.02, which represented the purchase price of the house, less closing costs, a construction mortgage and a debt to Dale Insulation. The Whorleys also gave Mr. Marsh their personal check in the amount of \$2,329.85 for the overrun on the floor covering allowances. Because the Whorleys were purchasing title insurance on the property, Mr. Marsh signed at closing an affidavit prepared by East Tennessee Title Ins. Agency, as agent for Chicago Title Insurance Co., which affidavit recited that there were "no unpaid bills or claims for labor or services performed or material furnished or delivered during the last 12 months for alterations, repair work or new construction" on the property.

Despite this representation, Yarber had not been paid for the materials supplied by it and, in fact, was never paid by Mr.

Marsh for the floor coverings installed in the house purchased by the Whorleys. As a result, on January 3, 1991, Yarber filed a "Notice of Mechanics' and Materialmen's Lien" with the Knox County Register of Deeds, claiming a lien in the amount of \$8,191.71 plus recording costs against the Whorleys' property. Thereafter, in order to enforce its lien, Yarber filed suit against the Whorleys and Mr. Marsh in state court and Chicago Title Ins. Co. defended the action on behalf of the Whorleys pursuant to their title insurance policy. Although the record is not clear, apparently Mr. Marsh filed a chapter 13 bankruptcy case a few months later, thus staying the lawsuit as to him. The state court action was ultimately settled, with the exception of Mr. Marsh, and Yarber assigned its claim against Mr. Marsh to the Whorleys and Chicago Title Ins. Co. Having received the assignment and settled the claim on behalf of the Whorleys, Chicago Title Ins. Co., apparently pursuant to the subrogation terms of the title policy, was thereafter the sole owner of the indebtedness. At some point, Mr. Marsh's chapter 13 case was dismissed and Mr. Marsh and his wife filed the underlying chapter 7 case on November 17, 1994.

## II.

Plaintiff asserts that the debt owed by Mr. Marsh for the

floor coverings installed in the Whorleys' house, which debt totaled \$11,381.83 as of the date the chapter 7 case was filed, is nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A). That section states in relevant part:

(a) A discharge under section 727 ... does not discharge an individual debtor from any debt - ...

(2) for money ... 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).

Plaintiff alleges that Mr. Marsh obtained the funds at closing by false pretenses, false representations and actual fraud. Specifically, Chicago Title Ins. Co. asserts that the representations in the Notice of Completion and the affidavit signed by Mr. Marsh at closing were false and were made with the intent to deceive. Plaintiff also alleges that Mr. Marsh's failure to disclose at closing that the Yarber debt had not been paid was a false representation rendering the debt nondischargeable. Mr. Marsh denies that any false representation was made or that there was any intent to deceive and maintains that he intended to pay Yarber but was unable to do so due to his subsequent financial decline.

As set forth by the Sixth Circuit Court of Appeals in *Coman v. Phillips (In re Phillips)*, 804 F.2d 930 (6th Cir. 1986), a creditor seeking to except a debt from discharge under § 523(a)(2)(A) of the Bankruptcy Code must prove: (1) the debtor obtained the 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 acted with intent to deceive; (3) the creditor justifiably relied upon the false representation; and (4) the creditor's reliance was the proximate cause of the loss. *Id.* at 932; *Field v. Mans*, \_\_\_ U.S. \_\_\_, 116 S. Ct. 437 (1995) (Supreme Court clarified that "justifiable" rather than "reasonable" reliance required).

### III.

The court will first address plaintiff's contention that the Notice of Completion signed by the debtor provides a basis for nondischargeability of the debt. As stated above, on November 9, 1990, Mr. Marsh executed a Notice of Completion stating that the house was completed on November 9, 1990. It is undisputed that at the time the Notice of Completion was signed, the carpet and other floor coverings had not been installed in the house and were not installed until three days later on November 12, 1990. Mr. Marsh testified at trial that he signed the Notice of

Completion when requested to do so by East Tennessee Title Ins. Agency even though the floor coverings had not yet been installed because the house was "substantially" complete. In Mr. Marsh's opinion, the Notice of Completion was only a representation that the "structure" was complete and he did not believe that the absence of floor coverings rendered the structure incomplete. Mr. Marsh also stated that at the time he signed the Notice of Completion, he had been advised that the Whorleys would be making the carpet arrangements and so he believed that his responsibilities for the construction of the house were in fact completed.

As noted above, the Whorleys deny that they ever told Mr. Marsh that they would pay Yarber directly for the carpet. Angie Yarber, co-owner and Yarber's office manager, testified that the Whorleys did not say or do anything to indicate to Yarber that they would be paying for the carpet instead of Mr. Marsh, that all of the invoices indicated that Mr. Marsh was purchasing the floor coverings, and that it was the standard and custom in her business for the cost of the flooring to be borne by the builder.

Applying the four criteria required to deny dischargeability under § 523(a)(2)(A) as recognized by the Sixth Circuit Court of Appeals in *Phillips*, this court is unable to conclude that the

Notice of Completion provides a basis for a finding of nondischargeability of the debt owed by Mr. Marsh to the plaintiff. As set forth above, the first element of the *Phillips* test is that the debtor must have obtained money through a material misrepresentation that the debtor knew at the time was false or the misrepresentation was made with gross recklessness as to its truth. Thus, in order to be actionable, the Notice of Completion must have provided the means by which Mr. Marsh obtained funds from the Whorleys. However, that was not the case. It was not any representation in the Notice of Completion that allowed Mr. Marsh to obtain payment at closing. Instead, what allowed the closing to proceed and Mr. Marsh to obtain payment was his representation at closing that there were no unpaid bills. By the time the closing was held, it was irrelevant if the Notice of Completion was correct concerning whether the house had been completed on November 9 or November 12, 1990. Accordingly, because the funds were not obtained through the alleged falsity of the Notice of Completion, it is unnecessary for this court to determine if the Notice of Completion was false and whether its asserted falsity was known by the debtor.

With respect to plaintiff's assertion that the debtor committed fraud by representing at closing that there were no

unpaid bills when, in fact, Yarber had not been paid, the court agrees. As stated above, in order for the Whorleys to obtain title insurance and the sale to be completed, Mr. Marsh signed at closing an affidavit which recited that there were "no unpaid bills or claims for labor or services performed or material furnished or delivered during the last twelve months for alterations, repair work or new construction" on the property. Clearly, this representation was false because the Yarber bill was outstanding and the misrepresentation was material because Mrs. Whorley testified that had she known at closing that Yarber had not been paid, she would not have closed on the house.

To be materially false, the misrepresentation "must not only be substantially inaccurate, but must be information that affected the creditor's decision-making process." *Bates v. Winfree (In re Winfree)*, 34 B.R. 879, 884 (Bankr. M.D. Tenn. 1983); see also *Swanson v. Tam (In re Tam)*, 136 B.R. 281, 286 (Bankr. D. Kan. 1992)(misrepresentation is "material" if it would likely affect the conduct of a reasonable person with regard to the transaction in question). Myron C. Ely, president of East Tennessee Title Ins. Agency, testified that had he known at closing that the affidavit was incorrect and that there were, in fact, unpaid bills remaining, he would have shown the \$8,191.71 amount owing to Yarber as a deduction on the closing

statement and reduced the proceeds paid to Mr. Marsh by this amount, as was similarly done for the construction mortgage and an unpaid debt to Dale Insulation. Because of the misrepresentation, Mr. Marsh was able to obtain significantly more money than he would have received had he correctly disclosed the facts.

The court also finds that Mr. Marsh knew at the time he executed the affidavit that it was false or that he signed the affidavit with gross recklessness as to its truth. At trial Mr. Marsh asserted at one point in his testimony that the representation in the affidavit that there were no unpaid bills or claims was true because he had not yet received the Yarber bill. However, the court did not find Mr. Marsh's testimony in this regard credible. Mrs. Whorley testified that at the walk-through of the house on the day of closing, Mr. Marsh had the invoices from Yarber in hand and he telephoned Yarber to question it regarding an error in the bill. Angie Yarber testified that Mr. Marsh called her on the day of closing questioning the bill and she gave him the corrected amount. The testimony of Mrs. Whorley and that of Mrs. Yarber are supported by the fact that the amount owed to Yarber was set forth in the "Settlement of Extra Charges" prepared by Mr. Marsh on the day of closing. Mr. Marsh testified that he obtained the figures in

the statement from Mrs. Whorley, but this testimony is illogical because there would have been no need for Mr. Marsh to prepare the statement if the Whorleys already knew the amount of overage they needed to pay.

More important, even if it were true that Mr. Marsh had not received Yarber's invoices by closing, Yarber still had a claim for materials supplied by it, which claim remained unsatisfied at closing. The court has no doubt that Mr. Marsh, an experienced residential contractor of 30 years, understood this and therefore knew that the representation in the affidavit to the contrary was false. Mr. Marsh's attempted naivete on this point was unconvincing.

During cross-examination, Mr. Marsh did admit that the affidavit was false, but explained that he signed it anyway because he had been signing affidavits like this for years and it was understood that most builders needed the money from closing to pay the remaining debts from the construction. Even if true, such testimony does not negate the falsity of the affidavit and at a minimum, demonstrates a gross recklessness on the part of Mr. Marsh as to the truth of the statements in the affidavit.

Notwithstanding the assertion by Mr. Marsh that at some point in his dealings with the Whorleys it was his belief that

the Whorleys would be paying Yarber and regardless of whether Mr. Marsh had the Yarber bill in hand by closing, it is undisputed that Mr. Marsh knew at closing that Yarber had provided materials for the construction of the house he was selling to the Whorleys, that he was responsible for payment of these materials, and that Yarber had not been paid. Accordingly, plaintiff has established the first element of *Phillips*, that Mr. Marsh obtained funds through a material misrepresentation that he knew was false or made with gross recklessness as to its truth.

A representation made with gross recklessness as to its truth and with the knowledge that it would induce a creditor to pay the money fulfills the "intent to deceive" element of § 523(a)(2). *In re Phillips*, 804 F.2d at 934; *Burleson Construction Co. v. White (In re White)*, 106 B.R. 501 (Bankr. E.D. Tenn. 1989). Mr. Marsh could have advised the parties at closing that Yarber had not been paid and the amount needed to pay this debt could have then been withheld from the proceeds with the balance remitted to the debtor. Mr. Marsh purposely chose not to disclose this fact and, to the contrary, expressly represented otherwise so he could receive a greater share of the proceeds.

The debtor argues that there was no intent to deceive

because he intended to pay Yarber after the closing, but the costs on the house ran more than he had anticipated and the money he obtained at closing was not sufficient to pay Yarber and all of his subcontractors and suppliers. Mr. Marsh testified that he had also planned to pay Yarber from the sale of another house that he had under construction, but that house did not sell in a timely manner and thereafter the war in the Middle East broke out which further exasperated his financial problems. It is the debtor's contention that the facts simply establish a good faith promise to pay which he was unable to keep due to his financial collapse and that promises to pay in the future do not provide a basis for fraud. See *Mason Lumber Co. v. Martin (In re Martin)*, 70 B.R. 146 (Bankr. M.D. Ala. 1987).

Mr. Marsh is correct that if he had represented at closing that he was going to pay Yarber in the future and had the intention to do so at the time, but was subsequently prevented from paying Yarber due to financial difficulties, such failure would not constitute fraud. This scenario, however, did not occur in this instance. Instead, Mr. Marsh's representation was not of future intent but of present fact - he knowingly misrepresented in the affidavit that there were no unpaid bills at the time of the closing. Because this representation was

made with the knowledge that it would induce the Whorleys to proceed with the closing, intent to deceive has been established, even if Mr. Marsh had no intent to harm the Whorleys as he claims.

The third and fourth necessary elements, that the creditor justifiably rely upon the false representation and that such reliance be the proximate cause of the loss, have been established in this case by the Whorleys' testimony that they relied upon the representation that all bills had been paid and that they would not have closed if they had known that there was any possibility that liens could be asserted against the house.

#### IV.

This court having found that the debtor made a materially false misrepresentation to obtain money from the Whorleys, that he had knowledge of the statement's falsity or the representation was made with gross recklessness as to its truth, that the Whorleys justifiably relied on the representation and this reliance was the proximate cause of the loss, the debt owed by the debtor to the plaintiff is nondischargeable under 11 U.S.C. § 523(a)(2)(A). An order will be entered in accordance with this memorandum opinion finding the debt nondischargeable and granting the plaintiff a judgment against the debtor in the

amount of \$11,381.83.

FILED: January 18, 1996

BY THE COURT

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MARCIA PHILLIPS PARSONS  
UNITED STATES BANKRUPTCY JUDGE