

preponderance of the evidence each of the elements of section 523(a)(2)(A), particularly reliance and a misrepresentation as to it.

FINDINGS OF FACT

1. Before bankruptcy, the Debtor operated an unincorporated electrical subcontracting business known as City Electric.

2. EDI is a wholesale distributor of electrical goods. From time to time EDI sold electrical supplies to City Electric on a credit basis for use in jobs for which City Electric was serving as an electrical subcontractor.

3. Much of the material EDI sold to City Electric was used in various construction projects for which City Electric provided electrical contracting services to a general contractor, Shelco, Inc. ("Shelco").

4. Before making progress payments to City Electric, Shelco required it to submit a "Subcontractor's Application for Payment." Each application included a lien waiver in which City Electric affirmed that all persons providing materials and service to City Electric for use on the Shelco projects had been paid in full.

5. Between October 2000 and September 2001, the Debtor submitted several lien waivers to Shelco indicating that all of its subcontractors, including EDI, had been paid in full. The representations made in the lien waivers were false, and Leonard

knew they were false at the time they were made, as City Electric had failed to pay EDI on several invoices.

6. On the basis of these lien waivers, City Electric received several progress payments from Shelco. Unfortunately, it did not pay EDI in turn.

7. City Electric's business failed in October 2001, and the Debtor filed a Chapter 7 bankruptcy case in this Court on December 20, 2001. As of the commencement of the bankruptcy, City Electric (and, thus, the Debtor) owed EDI \$96,443.15.

8. On August 4, 2002, EDI commenced this adversary proceeding against the Debtor.

CONCLUSIONS OF LAW

1. One of the primary reasons consumer debtors file bankruptcy is to receive a discharge of their financial obligations. However, a bankruptcy filing does not necessarily discharge all of a debtor's obligations. For example, in a Chapter 7 case a debt incurred by fraud or false pretenses will survive the bankruptcy upon the proper objection of a creditor.

2. In order to except Leonard's debt to EDI from discharge, EDI must prove four things: (1) a fraudulent misrepresentation by the Debtor; (2) which induced EDI to act or to refrain from acting; (3) which caused harm to EDI; and (4) upon which EDI justifiably relied. See *In re Biondo*, 180 F.3d 126, 134 (4th Cir. 1999). EDI has the burden of establishing each element by a preponderance of

the evidence. See *id.* (citing *Grogan v. Garner*, 498 U.S. 279, 291, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)).

3. There can be no dispute that the Debtor made fraudulent misrepresentations to Shelco when he certified in the lien waivers that City Electric had paid EDI. It is also undisputed that EDI was harmed by City Electric's failure to pay it.

4. However, this action fails because (1) Leonard made no representations to EDI, and (2) EDI did not rely on any representations made by Leonard in the Shelco lien waivers.

5. A misrepresentation made by one party to a contract to another party to the contract is not a misrepresentation to a third party unless the third party was an intended beneficiary of the contract. See *In re Patrick*, 265 B.R. 782 (Bankr.N.D.Ohio 2001); *In re Reeb*, 214 B.R. 319 (Bankr.S.D.Ohio 1997).

6. City Electric's lien waivers and, thus, the Debtor's misrepresentations, were made to Shelco and not to EDI. Moreover, there is nothing in these particular lien waivers which would evidence a mutual intention to make EDI a third party beneficiary of these documents. Thus, EDI cannot claim fraud upon the Debtor's misrepresentations.

7. Even if EDI was a third party beneficiary of the lien waivers, there is no evidence of any reliance by EDI on the representations made by Leonard to Shelco. EDI introduced no evidence which would demonstrate that it was aware of the lien

waivers, made any inquiry about the documents, or changed its position based upon their existence. EDI's Complaint does not even allege such reliance.

8. Rather, EDI argues that it has been harmed by the Debtor's submission of false lien waivers because Shelco's payments to City Electric caused it to lose its state law lien rights under Chapter 45 of the North Carolina General Statutes.

9. This assertion appears to be only partially accurate. It is true that under North Carolina law a lien on funds may be asserted by a subcontractor only to the extent a higher-tiered (sub)contractor has not been paid what is owing to it. See N.C. Gen. Stat. § 44A-18. However, North Carolina law also provides an alternative to a lien on funds in the form of a lien on the property which is being improved. See N.C. Gen. Stat. § 44A-23. With respect to this type of lien, despite payment to the entity above it in the construction chain, a subcontractor can still assert a subrogated lien against the premises. See *Electric Supply Co. of Durham, Inc. v. Swain Electrical Co., Inc.*, 328 N.C. 651, 403 S.E.2d 291 (1991).

10. One can speculate in this case about whether or not the loss of the lien on funds impaired EDI's ability to collect on its debt. However, the fact remains that City Electric's misrepresentation was not made to EDI. Moreover, EDI neither acted, nor refrained from acting, on the basis of the same.

11. As an alternative basis for nondischargeability, EDI argues that in the construction industry as a whole, the cost of materials for electrical projects runs about fifty percent (50%) of an electrical subcontractor's total bill. EDI's calculations suggest that the cost of materials on City Electric's construction projects was about eighty percent (80%) of total billings. Based on this calculation, EDI first presumes that the Debtor inflated the billed cost of City Electric's materials to Shelco, and then leaps to the conclusion that the Debtor was, in fact, draining money out of City Electric. EDI argues this was an act to intentionally hinder, delay, and defraud EDI, rendering City Electric's indebtedness to EDI nondischargeable.

12. This fanciful theory may or may not be true, but it certainly was not proven at trial. EDI's cost of material hypothesis is simply too speculative to be given any weight. Many factors affect product costs in the construction industry. Simply having a higher cost ratio than that of the industry as a whole does not prove an intentional dissipation of a company's assets. Since EDI did not present any evidence at trial tending to show that Leonard intentionally siphoned money out of City Electric, this cause of action also fails.

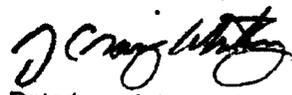
It is therefore **ORDERED**:

1. The Debtor owes EDI \$96,443.15;
2. However, this debt shall be dischargeable from the

Debtor's bankruptcy case; and

3. Judgment shall be entered for the Debtor/Defendant.

This the ____ day of February, 2003.



Dated as of date entered

United States Bankruptcy Judge

CHAMBERS DOCUMENT COVER SHEET

CASE NAME: EDI v. Richard Todd Leonard

ADVERSARY PROCEEDING NUMBER: 02-3068

TITLE OF DOCUMENT: Findings of fact, Conclusions of law, and order

SEPARATE JUDGMENT ATTACHED: () yes (X) no

CLERK PLEASE SERVE:

- Debtor, *pro se*
 - Attorney for Debtor
 - Trustee
 - Bankruptcy Administrator
 - Plaintiff's Attorney
 - Defendant's Attorney
- Other Rick Mitchell, attorney for EDI

DOCKET TEXT TO READ:

SPECIAL INSTRUCTIONS:

