2005 BNH 021 Note: This is an unreported opinion. Refer to AO 1050-1 regarding citation.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 01-13417-MWV
Chapter 7

Dana S. Georges,
Debtor

Exceptional Properties, Inc.,
Plaintiff

v. Adv. No. 02-1034-MWV

Dana S. Georges,
Defendant

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MEMORANDUM OPINION

The Court has before it the complaint of Exceptional Properties, Inc. ("Plaintiff"), against Dana S. Georges ("Debtor/Defendant") seeking that its debt be excepted from discharge and that the Debtor's discharge be denied. The complaint alleges that the debt due Plaintiff be excepted from discharge pursuant to § 523(a)(2)(A), (a)(4) and (a)(6),[1] and that the Debtor be denied his discharge pursuant to § 727(a)(3) and (a)(5). The Plaintiff did not pursue the 727(a)(5) count, and that count was dismissed. Likewise, the 523(a)(4) count, as it pertained to fraud or defalcation acting in a fiduciary capacity was dismissed at the conclusion of the Plaintiff's case.

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[1]Unless otherwise noted, all statutory section references herein are to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. § 101, *et seq*.

JURISDICTION

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

FACTS

The facts leading up to the instant controversy are generally not in dispute. The Plaintiff owned land in Hollis and Nashua, New Hampshire, which contained significant deposits of sand and a layer of loam. In 1995, the Plaintiff obtained a permit from the Town of Hollis, which was amended in 1997 to excavate the property. A permit was not required by the City of Nashua. In 1996, the Defendant began excavating work at the Plaintiff's site. On or about March 22, 1996, the parties entered into a written contract entitled "Memo of Understanding." (Pl.'s Ex. 1.) Pursuant to this contract, the Defendant could purchase materials from the site for $2.25 per cubic yard in the truck and would load material for customers of the Plaintiff for 50¢ per cubic yard. Over the course of the relationship, the $2.25 per cubic yard rose to $2.75 per cubic yard. The Defendant would re-sell the material he bought to his customers. The Defendant would account to the Plaintiff for material he loaded to the Plaintiff's customers as well as for material he bought. The parties would net the money they owed each other, and the Defendant would pay the difference to the Plaintiff.

In the spring of 2000, the Plaintiff terminated the contract on twenty-four hours' notice, which it was allowed to do pursuant to the contract. (Pl.'s Ex. 1.) The parties agree that the slips that the Defendant gave to the Plaintiff for materials purchased or loaded totaled 247,062 cubic yards. As a result of some survey work the Plaintiff was doing in connection with developing the land for housing, it was suspected that more material had been excavated than accounted for. A June 5, 2000, report prepared for the Plaintiff by Cuoco & Cormier Engineering Associates, Inc. ("C&C"), found that approximately

431,097 cubic yards of material had been removed from the pit. This amount was increased to 562,295 cubic yards using an in-truck methodology pursuant to an April 2003 report. It is the difference between the agreed-upon figure of 247,062 cubic yards and the report of 431,097 cubic yards or 562,295 cubic yards that forms the basis for this adversary proceeding. The Plaintiff alleges that it is owed between approximately $506,996 and $866,890, calculated as follows,

431,097		562,295
- 247,062		- 247,062
184,035		315,233
x $2.75		x $2.75
$506,096.25	and	$ 866,890.75

which debt should be excepted from discharge pursuant to § 523(a)(2)(A), (a)(4) and (a)(6). The Plaintiff further alleges that the Defendant should be denied his discharge pursuant to § 727(a)(3).

The adversary proceeding was tried over a period of four days and consisted largely of expert testimony of different methodologies of determining the actual amount of material removed from the property. The Defendant countered the conclusions reached by the Plaintiff's experts with a conclusion of its own expert. The Defendant's expert, Mr. O'Neil, concluded that the Plaintiff's report could be off by as much as 72,900 cubic yards due to the truck count method used. He further testified that the Plaintiff's volume computations were off by between 70,000 and 186,736 cubic yards, mainly on the basis that the original estimates of the materials available were inaccurate. Finally, he opined that there could be a difference of up to 58,000 cubic yards due to map inaccuracies.

It is undisputed that the trucks were not weighed, which is the most precise method of determining the amount of material loaded into each truck. The trucks were loaded with a bucket loader and the number of cubic yards per truck was estimated depending on the type of truck being loaded. It is further undisputed that in early 2000, the Nashua portion of the property was excavated to a level below the water level creating a pond of two to three acres in size. At trial, this was referred to as "Lake George."

DISCUSSION

In order to reach its decision, the Court must first determine whether the evidence supports a finding that material was missing and, if so, how much. This has nothing to do with bankruptcy law. If this Court finds that material is not accounted for, it must then determine a value of that material. Finally, the Court must determine if this debt should be excepted from discharge pursuant to § 523(a)(2) and (a)(4) or if the Defendant's failure to account for such material is sufficient to bar his discharge pursuant to § 727.

In order to determine whether material is missing and, if so, how much, the Court has reviewed the various reports referred to above. While the Court believes that any method of computing the material removed is subject to some inaccuracies, the Court believes that in-ground measurement of volume done by C&C to be the most accurate. C&C was familiar with the area being excavated. Its initial report prepared in June 2000 is supported by land surveys in 1995 and 2000. The assumptions used by C&C in its June 2000 report were checked in its 2003 report and found to have only de minimus adjustments. While each expert made certain assumptions in compiling their reports, the Court finds the assumptions utilized by C&C to be the most credible. Based on the June 2000 report, the Court finds that starting point to determine the amount of material removed is 431,097 cubic yards. The Court is not persuaded by the 2003 report that "fluff" and "swell" could be calculated to increase the volume to 562,295 cubic yards. The Court is, however, persuaded that there should be an adjustment based on the determination of value based on the truck size. As indicated above, the trucks were not weighed. Mr. O'Neil opined that approximately 72,000 cubic yards could be missing as a result of this method of determining volume. The Plaintiff has contested this finding indicating evidence that the O'Neil report made faulty assumptions as to the types of trucks used. While not being capable of making an exact determination, the Court finds that 36,000 cubic yards were not accounted for because of the method and would deduct

that amount from the 431,097 cubic yards, leaving a balance of 395,097 cubic yards that have not been accounted for.

To translate this amount into a dollar figure, the Court must multiply by the cost per cubic yard. The undisputed testimony is that during the term of the contract, the cost per cubic yard ran from $2.25 to $2.75. Since there is no testimony that could determine when the missing material was taken, the Court will use $2.50 to calculate the dollar value. The Court must first deduct the accounted-for material, 247,062 from the 395,097 to get a figure of missing material of 148,035. This is now multiplied by $2.50, which equals $370,087.50. To that figure, the Court will make on further minor adjustment. It will assume that one-half of the 36,000 adjustment for truck count went to customers of the Plaintiff, to which the Defendant was entitled to a 50¢ per cubic yard loading charge. The Court will credit the Defendant with $9,000 (18,000 cubic yards x 50¢). The Court finds that the value of the missing material is $361,087.50.

Having found that there is material removed that has not been accounted for, this Court must now determine whether the value of this material, as determined above, should be excepted from discharge pursuant to § 523 or whether the Defendant's discharge should be denied under § 727.

The Plaintiff, in its post-trial memorandum, indicated that it was seeking relief under three separate counts:

1. 523(a)(4), Embezzlement
2. 523(a)(2)(A), Misrepresentation/Fraud
3. 727(a)(3), Inadequate Business Records

The Plaintiff is evidently not pursuing the 523(a)(6), and the Court will find for the Defendant on that count.

Section 523(a)(2)(A) requires a finding that money or property in this case was obtained by false pretenses or false representation or actual fraud. The elements are that the Defendant "will be liable if (1) he makes a false representation, (2) he does so with fraudulent intent, i.e., with "scienter;" (3) he intends to induce the plaintiff to rely on the misrepresentation, and (4) the misrepresentation did induce reliance,

(5) which is justifiable; and (6) which causes damage (pecuniary loss)." Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997). The thrust of the Plaintiff's argument under this count is that the Defendant misrepresented the status of products sold to customers of the Defendant, which the Plaintiff relied on to his pecuniary loss. However, this Court does not see the nexus between the statement of account and the Defendant obtaining the Plaintiff's property. There is no question that prior to the termination of their agreement, the Defendant had the right to occupy the premises and either sell product to his customers or load product for customers of the Plaintiff. In essence, the unaccounted-for property was not obtained by a misrepresentation or actual fraud. The other allegation under this count is that the Defendant had alleged ownership of certain equipment that actually belonged to his father. While this may be true, there is insufficient evidence that the ownership of the equipment induced the Plaintiff to enter into the agreement with the Defendant. Likewise, there is no evidence that the representation caused damage to the Plaintiff. The Court finds for the Defendant under § 523(a)(2)(A).

However, the 523(a)(4) count is a different story. The Court has previously ruled that there is no evidence of a fiduciary relationship as required under the first portion of § 523(a)(4). Likewise, it is not contested that during the term of the agreement, the Defendant had a right to occupy and mine the property in question. That leaves the Court with the question whether the facts of this case support a finding of embezzlement. The Court believes that they do. Judge Deasy, in an unreported decision, Ansol, Inc. v. Jaworski (In re Jaworski), 2004 BNH 005 (Bankr. D.N.H. Feb. 20, 2004), adopted as the elements of embezzlement those outlined in Transamerica Commercial Fin. Corp. v. Littleton (In re Littleton), 942 F.2d 551 (9th Cir. 1991) which this Court now adopts. They are:

1. the relevant property was rightfully in the possession of the non-owner;
2. the non-owner appropriated the property for a use other than for which it was intended; and
3. the circumstances indicate fraud.

Transamerica Commercial Fin. Corp. v. Littleton, 942 F.2d at 555. The Court finds that the Plaintiff has met its burden on each of these elements.

First, in the instant case, the Defendant had a right to possession and control of this property in question, i.e., the sand and gravel. Not only did clauses 1 and 2 of the March 22, 1996, agreement give him the right to sell and load materials at the site, clause 4 of that agreement also gave him the right to manage the site.

1.	DANA:	May purchase materials from "The Sand Box" for $2.25 per cubic yard in the truck. He will report weekly to EXP the amount taken and pay for same.
2.	DANA:	Will load for EXP and bill EXP for each cubic yard in the truck loaded at the rate of 50¢ per cubic yard, and leave separate invoices for each EXP client weekly. EXP will invoice its clients on said yardage.
. . . .		
4.	DANA:	Acknowledges having received copies of Plan approved by the Town of Hollis for excavation of some 300,000 cubic yards of materials, the Planning Board conditions, the Site Specific Permit and Driveway Permit from the State of N.H. and will be responsible for all clients he loads to adhere to all requirements and to notify EXP immediately of any issues that are of concern to these referred requirements.

(Pl.'s Ex. 1.) Clearly, he was responsible for the premises. Testimony also showed that access to the property was restricted in that the Defendant had keys to gain access on the property.

The Court has already found that a significant amount of product was not accounted for. The use of the property that was granted to the Defendant was to mine the property and to account for the product that was mined. The amount of missing material clearly supports a finding that product that was not accounted for was appropriated by the Defendant. Failure to account for this product was an appropriation by the Defendant for a use other than intended. The Plaintiff has met its burden on the second element. Finally, the Court finds that the circumstances indicate fraud. Giving the benefit of the doubt to the Defendant above, the Court has found that a significant amount of material was not accounted for, i.e., 148,000 cubic yards. Fraudulent intent may be determined by the surrounding facts and circumstances of the case. Johnson v. Davis (In re Davis), 262 B.R. 663, 670 (Bankr. E.D. Va.

2001); Weigend v. Chwat (In re Chwat), 203 B.R. 242, 249 (Bankr. E.D. Va. 1996). In the instant case, the Court has found that the Defendant was in possession of the property and that a significant amount of material was not accounted for. Under these circumstances, the Court finds that an inference of fraud is warranted.

The final count the Court will address is whether the Debtor should be denied his discharge pursuant to § 727(a)(3) for failure to "keep or preserve any recorded information, including books, documents, records, and papers from which the debtor's financial condition or business transactions might be ascertained. . .." There does not appear to be any substantial dispute as to the legal standard to be applied, both the Plaintiff and the Defendant having cited some of the same cases. As stated in Nisselson v. Wolfson (In re Wolfson):

> Section 727(a)(3) is intended to allow the trustee and creditors to accurately determine the property in the debtor's estate and to compile a complete record of the debtor's relevant and material financial and business transactions. Though the statute does not require the "keeping of an impeccable system of bookkeeping . . . or records so complete that they could satisfy an expert in business," Esposito, 44 B.R. at 826 (quoting Johnson v. Bockman, 282 F.2d 544, 546 (10th Cir. 1960)), the test is "'whether there [is] available written evidence made and preserved from which the present financial condition of the [debtor], and his business transactions for a reasonable period in the past may be ascertained.'" Esposito, 44 B.R. at 827 (quoting In re Underhill, 82 F.2d 258, 260 (2d Cir.), cert. denied, 299 U.S. 546, 57 S.Ct. 9, 81 L.Ed. 402 (1936)). For a discharge to be denied under § 727(a)(3) it must be shown that the debtor either failed to keep or preserve records or that the debtor unjustifiably destroyed such records. It must then be shown that such failure or destruction makes it unduly burdensome to determine the debtor's financial condition and material business transactions. Groetzinger v. Rusnak (In re Rusnak), 110 B.R. 771 (Bankr. W.D. Pa. 1990); Matter of Decker, 595 F.2d 185, 187 (3rd Cir. 1979); Esposito, 44 B.R. at 827. Intent to conceal one's financial condition is not a necessary element for the denial of discharge under § 727(a)(3). See Esposito, 44 B.R. at 827; Rusnak, 110 B.R. at 775-776; Koufman v. Sheinwald, 83 F.2d 977, 978 (1st Cir. 1936); In re Underhill, 82 F.2d at 259.

Nisselson v. Wolfson (In re Wolfson), 139 B.R. 279, 286 (Bankr. S.D.N.Y. 1992). The evidence before the Court concerning the Defendant's business records consists of the Defendant's bank statements for the years 1999 to 2001 (Pl.'s Ex. 14), tax returns for the years 1997 to 2000 (Pl.'s Ex. 13), and a spreadsheet showing, by month, cubic yards of material sold by the Defendant for the years 1996 through early 2000. (Pl.'s Ex. 31 and Def.'s Ex. 121.) There were no invoices produced showing the individual transactions

to support the spreadsheet. The Defendant argued that he did not produce those documents because he did not want the Plaintiff to know who his customers were for purposes of competition. While this may have been a valid reason while the pit was operating, it was not valid at the time of the trial since the pit was not operating, and there was no competition. Likewise, the fact that the Defendant was a sole proprietor and not sophisticated in financial matters is not sufficient to explain the failure to provide any source documents concerning materials he sold from the pit. The bank statements produced are of little help as individual transactions of receipts or payments cannot be identified. Considering the evidence before the Court, the Court finds that the Defendant has failed to keep adequate records sufficient to determine the Defendant's business transactions concerning the operation of the pit. The Court finds for the Plaintiff on Count IV and denies the Debtor's discharge.

There still remains the counterclaim. The Defendant seeks compensation for loam allegedly left on the premises as well as the value of his work in trying to mitigate the "Lake George" situation. The Court finds insufficient evidence to support a finding that loam belonging to the Defendant remained on the premises. Likewise, it is more probable than not that the Defendant caused the formation of "Lake George," and it would be inequitable to compensate him for attempting to mitigate these damages. The counterclaim is denied.

CONCLUSION

This opinion constitutes the Court's findings and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate final judgment consistent with this opinion.

DATED this 1st day of July, 2005, at Manchester, New Hampshire.

/s/ Mark W. Vaughn
Mark W. Vaughn
Chief Judge