

**UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF
WASHINGTON AT TACOMA**

**Joseph M. Hale and Laurel A. Hale v. Eric Engelland and Charlene
Engelland**

Hale v. Engelland · No. Adversary No. 24-04031-MJH; Bankruptcy Case No. 24-40448-MJH · Decided March
12, 2026

OPINION

Hale

PER CURIAM.

Below is a Memorandum Decision of S==&, the Court. etree 9 ums Mary Jo on U.S. Bankruptcy
Judge 3 (Dated as of Entered on Docket date above) 4 5 6

7 UNITED STATES BANKRUPTCY COURT

8 WESTERN DISTRICT OF WASHINGTON AT TACOMA

9 In re: ERIC RON ENGELLAND, Case No. 24-40448-MJH 11 Debtor. 12|| JOSPEH M. HALE
and LAUREL A. 13 HALE, husband and wife, Adversary No. 24-04031-MJH 14 Plaintiffs, 15 v.

16|| ERIC ENGELLAND and CHARLENE MEMORANDUM DECISION

17|| ENGELLAND, husband and wife, Not For Publication 18 Defendants. 19 20 21 This matter
came before the Court for trial on October 22, 2025, on a complaint filed 22 || by Plaintiffs, Joseph
Hale (“Mr. Hale”) and his wife Laurel Hale (“Mrs. Hale”) (collectively 93 || “Plaintiffs”), against
Eric Engelland (“Mr. Engelland” or “Debtor”) and his wife Charlene 24 || Engelland (“Mrs.
Engelland”) (collectively “Defendants”) seeking the nondischargeability 25 || of debts pursuant to
11 U.S.C. § 523(a)(2)(A) and (B).1 Plaintiffs appeared at trial through 26 1 Unless otherwise
indicated, all chapter, section, and rule references are to the Federal Bankruptcy 27 Code, 11
U.S.C. § 101-1532, and to the Federal Rules of Bankruptcy Procedure, 1001-9037. 1 their
counsel, Snyder Law Firm, LLC and Klaus O. Snyder. Defendants appeared at trial 2 through their
counsel Allen Carlson PLLC and Christopher E. Allen. Based on the 3 evidence, arguments of
counsel, and pleadings submitted, the Court makes the following 4 findings of fact and
conclusions of law.

5 I. PROCEDURAL HISTORY

6 On May 31, 2024, Plaintiffs timely filed a complaint against Defendants seeking a 7
determination that certain amounts owed to Plaintiffs related to the renovation of their 8 home are
nondischargeable under § 523(a)(2)(A) and (B). Pls.’ Compl., ECF No.1. 9 On September 12,
2024, Plaintiffs moved for a default judgment against Defendants 10 for failing to file an answer.
Pls.’ Mot., ECF. No. 5.2 The Court entered an order to show 11 cause for lack of prosecution on
September 26, 2024. ECF No. 8. At the October 23, 2024 12 hearing, where only Debtor appeared

pro se, Plaintiffs were ordered to note their motion 13 for default on 21 days' notice to give Defendants an opportunity to obtain counsel. ECF

14 No. 13. Defendants filed an answer through their counsel on November 20, 2024, and
15 Plaintiffs withdrew their motion for default. Defs.' Answer, ECF No. 17. 16 Trial began on
October 22, 2025, and concluded on November 21, 2025. ECF. Nos. 51; 17 58. Plaintiffs sought
nondischargeability of debt plus the award of attorney's fees 18 pursuant to the terms of the
Homeowner Agreement FHA 203(k) Rehabilitation Program 19 contract ("203(k) Contract"). The
two main issues presented to the Court were whether, 20 pursuant to § 523(a)(2)(A): (i) Debtor
had a general intent not to pay certain 21 subcontractors and materialmen, and (ii) Debtor obtained
draw funds under the 203(k) 22 Contract by fraudulently misrepresenting that certain subcontractors
and materialmen 23 were paid according to the contract's terms. After Plaintiffs rested their case,
Defendants 24 25 2 Plaintiffs did not seek a default judgment against Mrs. Engelland because she
had not been personally served. There is no indication in the record that Mrs. Engelland was
subsequently personally served. 26 Nonetheless, she is deemed to have waived insufficient service
by failing to raise this defense in the Answer filed by her and Debtor. See Fed. R. Civ. P. 12(h)(1),
made applicable by Fed. R. Bankr. P. 7012; Defs.' 27 Answer, ECF No. 17. 1 moved for dismissal
of Plaintiffs' § 523(a)(2)(A) and (B) claims for relief under Fed. R. 2 Bankr. P. 7052 and Fed. R.
Civ. P. 52(c). This Court made an oral ruling dismissing 3 Plaintiffs' claim for misrepresentations
under § 523(a)(2)(B) based on the Plaintiffs' 4 failure to prove essential elements of their claim,
but denied dismissal of Plaintiffs' 5 § 523(a)(2)(A) claims. Defendants thereafter presented their
case. The Court heard 6 closing arguments on November 21, 2025, and took the matter under
advisement.

7 II. FINDINGS OF FACT

8 A. Chapter 7 Bankruptcy Proceeding. 9 Debtor filed his bankruptcy petition under chapter 7 on
February 29, 2024. Bankr. 10 Case No. 24-40448-MJH, ECF No. 1. Co-defendant, Mrs.
Engelland, did not file 11 bankruptcy. Debtor is the sole owner of Coba Construction LLC
("Coba"). Bankr. Case, 12 ECF No. 1. The schedules listed Plaintiffs' claim as an unsecured claim
in the amount of 13 \$151,731.00 and identified it as a "business liability." Bankr. Case, ECF No.
1. Plaintiffs 14 filed a proof of claim on May 3, 2024, in the amount of \$153,000.00, stating as its
basis 15 the "[u]njust enrichment and fraud from monies paid for services." Bankr. Case, Claim 7-
16 1. Debtor was granted a discharge on September 26, 2024. Bankr. Case, ECF No. 37. 17 Before
discharge, Plaintiffs filed this adversary proceeding on May 31, 2024. 18 B. The Dream Home in
the North End Neighborhood of Tacoma, Washington. 19 Plaintiffs both worked in positions
within the technology industry and had no 20 expertise in home renovation or construction. In late
2022, Mrs. Hale was diagnosed with 21 breast cancer, and in February 2023, Plaintiffs bought a
single-family residence located 22 at 4716 N. 45th St., Tacoma, WA ("Home"). Mr. Hale
described the Home as their future 23 "dream home." The Home was over a century old and
needed major renovations for it to 24 be habitable. 25 Plaintiffs used a Section 203(k)

Rehabilitation Mortgage loan backed by Federal 26 Housing Authority Mortgage Insurance that allowed them to finance both the purchase 27 1 price of the Home as well as the cost of certain renovations within a single long-term loan. 2 The total loan amount was secured by the Home as renovated and based on its value. 3 Plaintiffs' 203(k) lender was Fairway Independent Mortgage Corporation ("Lender"). 4 Under the 203(k) process, Plaintiffs were required to hire a certified Federal Housing 5 Authority inspector to act on their behalf in certifying the 203(k) renovation loan 6 disbursements and inspecting the work of a hired contractor. In December 2022, 7 Plaintiffs' realtor requested Roger Merrell, a Housing and Urban Development inspector 8 with the required credentials, to inspect the Home. In January or February 2023, Merrell 9 prepared a Preliminary Deficiency & Compliance Report and Specification of Repairs 10 ("Deficiency List"). Pls.' Exs. 4–5. Merrell's Deficiency List set out line-items of repairs 11 needed for the Home to meet minimum building code standards. Through Lender's 12 network, Plaintiffs met Debtor and agreed that Debtor's company Cobra would renovate 13 the Home using the Deficiency List under the 203(k) Contract. 14 C. The 203(k) Contract Between Plaintiffs and Cobra. 15 Plaintiffs and Debtor, through Cobra, entered into the 203(k) Contract to rehabilitate 16 the Home. Project completion was set for no later than six months after closing unless 17 delayed beyond Cobra's control. Plaintiffs expected the first phase of the Home project to 18 be completed prior to Mrs. Hale's last chemotherapy treatment so that she could enjoy 19 the primary bedroom area when she moved in. It is undisputed that the Home project 20 was under demanding time constraints. 21 The original 203(k) loan amount was \$151,730.80 and was supported by the 22 Deficiency List. The Deficiency List contained line-items with specific threshold budgets 23 (e.g., \$19,261.00 for cleanup, \$1,551.00 for windows, \$7,700.00 for electrical, etc.) that 24 Cobra needed to complete for the Home to comply with minimum building code standards. 25 Within the Deficiency List's "cleanup" line-item, there were sub line-items like: "general" 26 for \$2,640.00; "hazmat demo," which included asbestos and lead abatement, for 27 \$9,251.00; and "demo" for \$7,370.00. If a certain line-item or outside cost ran over budget, 1 there was a contingency of \$15,173.183 to cover those unplanned expenditures. The Court 2 found Debtor's testimony credible as he explained that the budget provided by the 203(k) 3 Contract was insufficient for the scale of renovating a 100-year-old home and that he 4 informed Plaintiffs and Merrell about his concern that additional funds would be needed 5 for this reason. Another reason for additional funds was because Plaintiffs had "wants" 6 outside the scope of the 203(k) Contract's renovation loan for a primary bedroom with a 7 bathroom and closet space, which were expected to be completed in time for Mrs. Hale's 8 homecoming. Later in the Home project, additional funds were added to the 203(k) 9 Contract's loan to address certain unforeseen issues including an unexpected roof issue, 10 increasing the contract total to \$181,384.004. Still, the 203(k) loan proceeds were not 11 enough for Cobra to feasibly address all the structural needs and Plaintiffs' "wants" to 12 complete the first phase of the Home renovation described below. 13 D. The Home Project's "Phase 1" Work Within the Scope of the 203(k) Contract 14 and Outside It. 15 Debtor

did not have a concrete architectural plan or design provided by Lender, 16 Merrell, or Plaintiffs. Debtor realized the Home project's challenges when trying to 17 accommodate the structural engineering overhaul and Plaintiffs' "wants." Debtor put 18 together a general plan for the 100-year-old Home addressing the insufficient budget and 19 its tight timeframe. To commence work before the availability of the 203(k) Contract's 20 funds, Debtor drafted an initial funds agreement that ran parallel with the scope of the 21 203(k) Contract. Pls.' Ex. 42. The initial funds were used to supplement costs for 22 architectural design, structural planning, window and exterior siding repair, and 23 abatement. It is not disputed that Plaintiffs were to pay Coba an additional \$32,500.00 24 25 3 The contingency budget was 10% of the 203(k) Contract loan amount. 26 4 There was no testimony regarding the exact date of when the budget increased, but Plaintiffs' Exhibits 17–18 show that the budget increase occurred sometime between the release of Draw 2's funds and the

27 Draw 3 request.

1 in initial funds to supplement the Home project's insufficient funding. Plaintiffs, by 2 email, agreed to pay Coba the total amount of the initial funds, and they paid \$22,500.00 3 upfront. Plaintiffs never paid the remaining \$10,000.00. Nonetheless, the initial funds 4 for the specific items together with the 203(k) Contract amount were insufficient to 5 complete Phase 1 on the 100-year-old home.

6 The 203(k) Contract and work performed outside the 203(k) Contract's scope shaped

7 Phase 1 of the Home project. Plaintiffs disputed Phase 1's scope, believing that the only

8 governing documents were the Deficiency List and the scope of work under the 203(k) 9 Contract. Plaintiffs argued that work outside the scope of the 203(k) Contract was also 10 governed by the 203(k) Contract. But the Court finds that the scope of Phase 1 11 encompassed funds for work designated under the 203(k) Contract, work funded by the 12 initial supplemental funds, and other necessary work outside the 203(k) Contract's scope 13 that Coba performed to complete Phase 1. Thus, over the course of the Home project,

14 Phase 1 included work performed without a contract or agreement in place, and such

15 work was necessary in order for the 100-year-old Home to be structurally sound and meet 16 Plaintiffs' "wants" for Phase 1. 17 E. The Draw Process under the 203(k) Loan Contract. 18 Over the course of Coba's work on the Home from April to August 2023, there were 19 three draws for work performed under the 203(k) Contract: Draw 1, Draw 2, and Draw 3. 20 The procedure for such draws was as follows: Coba sent invoices to Merrell, who inspected 21 the work onsite. Merrell would affirm the work and reflect 100% payment for draw items 22 that were fully completed on the Deficiency List. Pls.' Exs. 16–17. The dollar amount 23 corresponding to each approved line-item would be disbursed, and if an unexpected cost 24 arose outside the line-item, the contingency fund was used to cover it.

25 Draws 1 and 2 contained standard conditional waiver releases from Merrell

26 Inspection Services LLC (Merrell's inspection company) ("MIS Waivers"). Pls.' Exs. 16– 27

17. By signing the MIS Waivers, Debtor agreed “this document shall become effective to 1 release pro tanto any mechanic’s lien, stop notices or bond right the undersigned has on 2 the job of [Plaintiffs] located at [Home] to the following extent.” Pls.’ Ex. 16. The MIS 3 Waivers contained additional language as follows: “release covers a progress payment for 4 labor, services, equipment, or materials furnished to: [Plaintiffs] through to [Date]. This 5 release covers the final payment to the undersigned for all labor, services, equipment, or 6 material furnished on this job.” Pls’ Exs. 16–17. 7 A dispute arose during trial regarding the interpretation of the MIS Waivers. 8 Plaintiffs interpreted the MIS Waivers as a representation that Debtor had paid the 9 subcontractors and materialmen prior to making the respective draw request. (emphasis 10 added). Merrell testified that the MIS Waivers’ language meant that the funds released 11 for Draws 1 and 2 would be used by Debtor to pay for the subcontractors and 12 materialmen. (emphasis added). The Court finds Merrell’s interpretation to be the correct 13 interpretation of the MIS Waiver language for Draws 1 and 2.

14 Draw 3’s waiver (“Lender’s Waiver”), which was prepared and provided by Lender, 15 was different from the MIS Waivers’ terms. Under Lender’s Waiver, a definition of “work” 16 was provided unlike in the MIS Waivers. “Work” was defined as construction, repair, 17 and/or replacement of improvements on the real property. Pls.’ Ex. 55. Lender’s Waiver 18 further stated the contractor represents and warrants that: 19 [A]ll persons or entities who furnished services, labor or materials to [c]ontractor in connection with the Work have been paid all amounts to 20 which they have or may become entitled, therefore, and . . . [c]ontractor’s portion of the Work is fully completed in accordance with the final plans 21 and specifications . . . 22 Pls.’ Ex. 55 (emphasis added). The Court finds that the Lender Waiver’s definition of 23 “work” covers only work on the Home under the scope of the 203(k) Contract spanning 24 Draws 1–3 but not work performed outside of the 203(k) Contract.

25 26 27 1 F. Breaking Ground and the Execution of Draw Requests. 2 In April 2023, Coba broke ground on the Home project for Phase 1. Coba submitted a 3 draw request on May 3, 2023. Debtor invoiced \$67,145.135 for work performed on Draw 1. 4 The invoice included non-hazmat testing and reporting, sewer scope, asbestos abatement, 5 as-built plan by architecture and design, structural engineering, non-hazmat demolition, 6 and permitting. The invoice was sent to Plaintiffs, Lender, and Merrell. Plaintiffs testified 7 they received the invoice and were aware of the costs. 8 The aforementioned work performed was extensive, but Debtor’s invoiced line-items 9 were funneled on the Deficiency List as line-items for cleanup and miscellaneous. Coba’s 10 employees completed all the work included on the invoice other than the asbestos 11 abatement, which was performed by Northwest Abatement. Coba’s invoice showed that 12 Coba completed \$27,102.00 worth of work, while Northwest Abatement completed 13 \$33,800.00 for asbestos abatement, significantly in excess of the \$9,251.00 estimated for 14 asbestos abatement in the 203(k) Contract. Pls.’ Exs. 5; 16. Merrell inspected the work 15 and affirmed 100% completion for cleanup and miscellaneous in the amount of \$19,811.00. 16 In addition, the \$14,480.00 was

disbursed from the contingency fund for engineering and 17 permitting costs. 18 The Draw 1 disbursement was \$34,291.00. This was \$32,854.13 less than the amount 19 invoiced by Coba. Nevertheless, Coba continued to work on the Home and signed Draw 20 1's MIS Waiver. Coba did not pay Northwest Abatement's bill of \$33,800.00, nor did Coba 21 remit any of the \$9,251.00 allotted funds for "hazmat demo" to them, although Debtor 22 testified that all draw funds were contributed to the Home project. 23 On June 13, 2023, Coba submitted a second draw request. Coba invoiced an 24 additional \$61,456.34 for Draw 2. The invoices again were sent to Plaintiffs, Lender, and 25 Merrell. Coba completed all the work for Draw 2, and Merrell inspected the 203(k)-related 26 5 The Court was provided Pls.' Ex. 16 in physical form. Due to the invoice's faint print, the total reads 27 as either \$67,143.13 or \$67,145.13. The Court reads the total invoice as \$67,145.13. 1 work and indicated that 100% was complete per job line-item. But due to an uncovered 2 roof area needing repair, \$12,950.006 was utilized from the 203(k) Contract contingency 3 to cover this cost, substantially depleting it. Testimony by Merrell and Coba's former 4 employee, Shane Murray, stated that projects like Plaintiffs' Home can vary drastically 5 and be a "can of worms." The unexpected repairs and reworkings of the project raised 6 Coba's costs, yet Lender only disbursed \$24,155.00 for Draw 2. Pls.' Ex. 17:5. Lender was 7 short on Coba's invoice again. Debtor signed Draw 2's MIS Waiver and received the 8 shorted payout. Coba continued to work on the Home albeit being short \$37,301.34 for 9 Draw 2. The total balance due to Coba at this time was \$70,155.47.7

10 Coba submitted a third draw request on July 24, 2023. For Draw 3, Coba invoiced an 11 additional \$117,179.258 and completed work on exteriors, windows, partition walls, and 12 the basement. Pls.' Ex. 18:6. Coba subcontracted for plumbing, electrical work, and 13 heating, and Coba did the underlying preparation work for these subcontractors. Coba 14 hired a plumbing subcontractor for \$8,272.50 and also purchased materials from a 15 window supplier. Pls.' Ex. 83. Plaintiffs, Merrell, and Lender were given an invoice from 16 Debtor, and Plaintiffs acknowledged receipt of the invoice. Plaintiffs testified they 17 received the invoice and took issue with large costs on the project. According to Merrell, 18 all work invoiced for the 203(k) Contract draw items were inspected, completed, and 19 allotted their full 203(k) Contract line-item amounts, including plumbing (\$18,532.009), 20 electrical (\$7,700.00), and heating (\$4,820.0010). 21 6 Exhibits provided during trial show that another \$12,950.00 was allocated as a contingency cost for 22 the uncovered roofing repair on Draw 2, although the record shows that the contingency was nearly depleted after Draw 1. The Court is aware of the inconsistent budget representations; there was no testimony 23 explaining the contingency's budget increase between Draws 1 and 2. 7 Total sum of unpaid invoice amounts for Draws 1 and 2. 24 8 Lender edited the invoice to add \$20.00 for work performed on heating, increasing the invoice amount 25 from \$117,159.25 to \$117,179.25. Pls.' Ex. 18:6. 9 Debtor hired a subcontractor named Rick the Plumber who invoiced \$8,272.50. 26 10 After Debtor was fired, Plaintiffs readjusted the Deficiency List's line-item allotment for heating to 27 \$36,551.20 and expensed the remaining

\$31,731.20 on their fourth draw. See Pls.’ Exs. 18–19. 1 On August 7, 2023, Debtor signed the Lender’s Waiver, acknowledging Lender’s 2 Waiver language that all subcontractors and materialmen “have been paid all amounts” 3 owed on the Home project. Cobra did not pay Draw 3’s subcontractors in full prior to 4 receiving the funds and as of that date had not paid Northwest Abatement in any amount. 5 Also, Cobra did not pay \$862.54 to a window supplier for materials. Draw 3 disbursed 6 \$46,815.00 to Cobra, resulting in a total accumulated shortage of \$70,364.25 owing to Cobra 7 for work performed outside of the 203(k) loan. Debtor testified he had a conversation with 8 Plaintiffs about being short \$70,000.00 and expressing hope that they could cover the 9 shortage when they sold their other home or from anticipated bonuses. Plaintiffs 10 acknowledged the shortage and that they were trying to sell their other home to “close 11 the gap entirely.” Pls.’ Ex. 13. In the meantime, Plaintiffs informed Debtor they wanted 12 to pause work to get him caught up on payments through draw funds and to clarify the 13 remaining scope of work. Id. 14 G. Cobra is Fired and Allegations of Fraud against Debtor. 15 On August 16, 2023, Plaintiffs received an email from Northwest Abatement that 16 they were going to place a lien on the Home because they have not received any payment 17 on their invoice from May 16, 2023. On August 17, 2023, Northwest Abatement filed a 18 notice of a claim of lien on Plaintiffs’ Home for \$33,641.50¹¹. The same day Plaintiffs 19 received Northwest Abatement’s email, Plaintiffs fired Cobra. At trial, Plaintiffs testified 20 they were disgruntled by the progress on the Home project, considering the six-month 21 deadline under the 203(k) Contract and Phase 1’s completion for Mrs. Hale’s 22 homecoming. Debtor emailed and called Plaintiffs, and during trial testified, that at that 23 time he was still willing to work on the Home project, but they rejected his offer. 24 Around the time Cobra was fired, multiple employees quit Cobra. Testimony by former 25 Cobra employees Lauren Martin, Josh Ord, and Shane Murray explained that they left 26 11 Northwest Abatement’s invoice was \$33,641.50. Cobra invoiced abatement performed by Northwest 27 Abatement for \$33,800.00. 1 Cobra because Debtor informed them that funds were tight, Debtor was not able to pay 2 for supplies on the Home and other Cobra projects, and that certain subcontractors and 3 materialmen were not yet paid the amounts owed to them. Mr. Hale testified that Debtor 4 told him that he paid the subcontractors what they were owed. Debtor testified that his 5 general comments to Mr. Hale were that subcontractors would get paid and Debtor would 6 make sure of it. Debtor acknowledged through testimony that it was likely that Mr. Hale 7 understood his general comments to mean that Debtor would take care of it, assuring 8 him that there was nothing to worry about. Debtor further testified that he believed he 9 would be able to pay subcontractors what they were owed because the work on the 10 invoices was completed, but because Lender and Plaintiffs did not pay Cobra and Debtor, 11 Debtor ultimately could not pay the subcontractors. 12 Plaintiffs testified that they did not want to continue working with Debtor or Cobra 13 due to the lien, nonpayment of certain subcontractors and materialmen, and failure to 14 meet prompt deadlines. At the time Cobra was fired, Cobra had not paid draw amounts 15 obtained through the 203(k) Contract to four subcontractors—Northwest Abatement,

16 plumbing, heating, and electrical—and one materialman for window supplies, totaling 17 \$30,906.04. After Coba was fired, Plaintiffs had approximately \$76,000.00¹² in loan funds 18 remaining on the 203(k) Contract to complete the rest of the required work to meet 19 building codes and address the Deficiency List. 20 Plaintiffs continued with the Home project and removed Northwest Abatement’s lien 21 from their home, though there was no testimony in the record about whether or how such 22 lien was satisfied or why it was withdrawn. Multiple subcontractors who were not paid 23 for work within the scope of the 203(k) Contract contacted Plaintiffs and threatened to 24 25 26 12 There was no testimony about how much specifically remained on the 203(k) Contract’s loan amount. The Court subtracted all draw disbursements to Coba from the total revised budget of \$181,384.00, leaving 27 \$76,123.00. See Pls.’ Exs. 16–19; 55. 1 place liens on their Home. Plaintiffs paid such subcontractors out of pocket as more fully 2 set forth below. 3 Plaintiffs allege that Debtor’s individual conduct, through Coba, was a fraudulent 4 misrepresentation of his duties under the 203(k) Contract. They argue that Debtor 5 fraudulently obtained funds through the 203(k) Contract, that Debtor’s work performed 6 caused superfluous expenses on the Home project, and that Debtor intended to keep the 7 funds without paying certain subcontractors or materialmen. Conversely, Debtor stated 8 that he was working on paying those subcontractors and materialmen but could not pay 9 them timely because he struggled with cash flow problems due in part to Lender’s draw 10 shortages on a 100-year-old home renovation and Plaintiffs’ failure to pay such shortages 11 on the invoices. 12 During trial, Plaintiffs’ presented an exhibit that listed their total damages amount 13 at \$66,619.96. Pls.’ Ex. 113. During closing arguments, Plaintiffs further elaborated that 14 \$41,621.70 are nondischargeable damages. Debtor asserted consistently throughout trial 15 that Coba was owed approximately \$70,000.00 for unpaid work performed on the Home.

16 III. DISCUSSION

17 A. Jurisdiction. 18 This Court has jurisdiction over the adversary proceeding under 28 U.S.C. § 1334(b). 19 A bankruptcy court has jurisdiction over “all civil proceedings arising under title 11, or 20 arising in or related to cases under title 11.” 28 U.S.C. § 1334(b). Specifically, bankruptcy 21 courts have exclusive jurisdiction to determine the dischargeability of debts under 22 § 523(a) (2), (a)(4), and (a)(6). See *In re Everly*, 346 B.R. 791, 796 (B.A.P. 8th Cir. 2006). 23 B. Dismissal of Mrs. Engelland from Adversary Proceeding. 24 Plaintiffs commenced this nondischargeability proceeding against both Debtor and 25 Mrs. Engelland, Debtor’s non-filing spouse. The Court concludes that Plaintiffs have 26 presented no legal or factual grounds to support a nondischargeability determination 27 against Mrs. Engelland. Mrs. Engelland is not a debtor in this bankruptcy case, and thus 1 not subject to a nondischargeability determination. Additionally, Plaintiffs have failed to 2 allege, let alone establish, any involvement by Mrs. Engelland with the Home project or 3 any fraudulent conduct by her, either under § 523(a)(2)(A) or (B). All claims asserted 4 against Mrs. Engelland are dismissed with prejudice. 5 C. Pleadings Are Amended to Conform to the Evidence and Defendant Added. 6 During the course of litigation, Debtor

repeatedly argued and presented supporting 7 evidence that Cobra was owed at least \$70,000.00¹³ for work performed on the Home that 8 was never paid by Plaintiffs. When Debtor asserted this defense, which the Court views 9 as a recoupment defense, Plaintiffs did not object, but rather litigated the issue during 10 trial and closing, arguing that (1) Debtor and Cobra assumed the risk for expenses accrued 11 outside of the 203(k) Contract budget and that Plaintiffs were not liable for them, and (2) 12 Debtor was fraudulently deceptive by taking draw funds and not using them as intended. 13 The Court must determine whether, pursuant to Fed. R. Civ. P. 15(b), the pleadings 14 should be constructively amended to conform to the evidence presented and whether Cobra 15 should be added as a defendant to this proceeding, pursuant to Fed. R. Civ. P. 21. 16 Under Fed. R. Civ. P. 15(b)(2), made applicable by Fed R. Bankr. P. 7015, when an 17 issue is not raised by the pleadings but is tried by the parties' express or implied consent, 18 it must be treated in all respects as if raised in the pleadings. Consent is found when 19 evidence is introduced with no objection. See *In re Vickery*, 488 B.R. 680, 694 (10th Cir. 20 BAP 2013). Implied consent is found when a party either introduces evidence on the new 21 issue or fails to object when the opposing party introduces such evidence. *Id.* (citing *Green 22 Country Food Mkt., Inc. v. Bottling Group, LLC*, 371 F.3d 1275, 1280 (10th Cir.2004)). 23 The trial court has broad discretion when conforming to pleadings with the evidence 24 presented. See *id.*; see also *In re Crawford* 841 F.3d 1, 6 (1st Cir. 2016) (where the court 25 13 The Debtor did not assert a specific dollar amount, but the record before the Court supports Cobra's 26 argument that it is owed at least \$70,000.00. Additionally, the evidence shows that the value of the work performed by Cobra far exceeds the amount Plaintiffs paid Cobra under the 203(k) Contract and initial 27 funding agreement. 1 found that there was implied consent under Fed. R. Civ. P. 15(b) because the debtor did 2 not object and failed to object to the unpleaded claim); *Miller v. Mills Const., Inc.*, 352 F.3d 3 1166, 1171 (8th Cir. 2003) (where court found that debtor did not expressly consent to try 4 the issue of the breach of contract, but nevertheless, consent may be implied from its 5 failure to object to the introduction of such evidence). 6 Here, Plaintiffs impliedly consented to litigating whether Cobra was still owed at least 7 \$70,000.00 for work performed on the Home. Debtor made this argument in his trial brief, 8 during opening statements, and during his testimony. From October 10 to November 21, 9 2025, Plaintiffs were aware of this issue and did not object to it on the record. More so, 10 during closing arguments, Plaintiffs made arguments against Debtor's claim that 11 Plaintiffs still owed Cobra \$70,000, without objecting to the issue being raised. Because 12 the issue was raised multiple times throughout the course of the trial without objection 13 by Plaintiffs, and Plaintiffs presented counterarguments against the defense, the Court 14 concludes that pursuant to Fed. R. Civ. P. 15(b), the pleadings should be constructively 15 amended to include what is effectively a recoupment defense to Plaintiffs' claim for 16 nondischargeable damages, thereby conforming the pleadings to the evidence admitted. 17 See *In re Vickery*, 488 B.R. at 694. 18 The Court also has authority, on just terms, to exercise its discretion to add or drop a 19 party under Fed. R. Civ. P. 21, made applicable by Fed. R. Bankr. P. 7021. See *Mendoza 20 v.*

Nordstrom, Inc., 865 F.3d 1261, 1266 (9th Cir. 2017) (citing *Rush v. Sport Chalet, Inc.*, 21 F.3d 973, 974 (9th Cir. 2015) (court's decision to dismiss a defendant under Rule 21.22 is reviewed for abuse of discretion)). A court may exercise its discretion under Fed. R. Civ. P. 21.22 sua sponte at any time. See *Campos v. Fresno Deputy Sheriff's Ass'n*, 535 F. Supp. 2d 913, 928 (E.D. Cal. 2021). Plaintiffs commenced this adversary proceeding against Debtor and his wife only, not Coca, even though the contracting parties were Plaintiffs and Coca, and all damages Plaintiffs incurred related to work performed on the Home by Coca. Because the Plaintiffs' claims for damages for work performed on the Home were not previously liquidated, in order to prove their damages element under § 523 at trial, Plaintiffs were required to establish their damages against Coca. While Debtor did the work on the Home, Debtor consistently argued that it was his 100% owned entity, Coca, that was owed money by Plaintiffs, and the parties presented evidence to this effect. Because a recoupment defense necessarily belongs to Coca as the contracting party, the Court concludes that adding Coca as a defendant to this proceeding reflects the case as it was actually litigated, and thus is the just result. Accordingly, Coca is added as a defendant to this proceeding. D. Washington State Participation Liability Applies to Debtor. Plaintiffs allege that Debtor is personally liable for any nondischargeable debt under § 523(a)(2)(A) for alleged misrepresentations made, although Coca was the entity performing under the 203(k) Contract and all of Plaintiffs' damages arose from Coca's renovation of the Home. The Court must determine whether Debtor has potential participation liability through Coca and may be subject to personal liability under § 523(a)(2)(A) before turning to the elements of Plaintiffs' claims. Officers are personally liable for the torts of corporations when officers knowingly commit wrongful acts or direct others to do so knowing the wrongful nature of the requested acts. See *Annechino v. Worthy*, 175 Wash.2d 630, 637 (2012); see also *Dodson v. Economy Equip. Co.*, 188 Wash. 340, 343, 62 P.2d 708 (1936) (finding president and general manager liable when they had directly participated in conversion of property); see also *Johnson v. Harrigan-Peach Land Dev. Co.*, 79 Wash.2d 745, 753, 489 P.2d 923 (1971) (finding officers liable when they participated in fraudulent acts and maintained close control). "This liability does not depend on piercing the corporate veil." *R.N. v. Kiwanis Int'l*, 19 Wash. App. 2d 389, 410, 496 P.3d 748, 760 (2021) (citing *State v. Ralph Williams' N. W. Chrysler Plymouth, Inc.*, 87 Wash.2d 298, 322, 553 P.2d 423, 439–40 (1976)). When determining whether a corporate officer should be liable for statements constituting misrepresentation, the evidence must support a factual finding that the corporate officer participated in, or knew of, the issuance of the allegedly fraudulent statement, or approved or sanctioned it. *Crescent Mfg. Co. v. Hansen*, 174 Wash. 193, 198, 4 P.2d 604 (1933); see also *Dodson*, 188 Wash. at 342–343 (where the Washington Supreme court held that the president and general manager was personally liable for conversion of an ice machine because he directly assisted in the conversion); *Johnson*, 79 Wash. at 753 (where the court held that the corporate officers were liable for

8 misrepresentations and fraud because the evidence strongly showed that they knowingly 9 participated in and directed the fraudulent activity). 10 Here, the Court finds that Debtor is subject to potential participation liability for 11 alleged misrepresentations because of his direct and exclusive control over Cobra while 12 working on the Home project. Debtor is the sole owner of Cobra and has exclusive control 13 over the entity, manages and coordinates projects like the one at issue, and employs 14 Cobra's employees. Regarding the Home project, Debtor signed the 203(k) Contract, 15 represented that all subcontractors and materialmen were paid, and personally signed 16 all waivers. Based on the evidence before the Court, the Debtor had exclusive control over 17 Cobra during the Home project and was the sole participant in the alleged fraudulent 18 conduct. Therefore, Debtor is subject to participation liability and may be personally 19 subject to a nondischargeability determination under § 523(a)(2)(A), even though Cobra 20 was the entity that entered into the 203(k) Contract. 21 E. Nondischargeability under § 523(a)(2)(A) in General. 22 Plaintiffs present two main theories for Debtor's nondischargeable liability: (i) Debtor 23 had the general intent not to pay certain subcontractors and materialmen employed to 24 renovate the Home; (ii) Debtor obtained funds under the 203(k) Contract by fraudulently 25 misrepresenting that four subcontractors and one materialman were fully paid according 26 to the contract's terms. The Court will address these issues separately. 27

1 Section 523(a)(2)(A) states:

2 A discharge under sections 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . for 3 money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by— false pretenses, a false representation, 4 or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. 5 The creditor bears the burden of proving the applicability of § 523(a)(2)(A) by a 6 preponderance of the evidence. In re Sabban, 600 F.3d 1219, 1222 (9th Cir. 2010); see In 7 re Slyman, 234 F.3d 1081, 1085 (9th Cir. 2000)). The Ninth Circuit Court of Appeals has 8 consistently held that to prevail on a § 523(a)(2)(A) claim the creditor must demonstrate 9 by a preponderance of the evidence that: (1) the debtor made representations; (2) that at 10 the time he knew were false; (3) that he made them with the intention and purpose of 11 deceiving the creditor; (4) that the creditor justifiably relied on such representations; and 12

(5) that the creditor sustained the alleged loss and damage as the proximate result of the 13 misrepresentations having been made. Id. (citing Am. Express Travel Related Servs. Co. 14 v. Hashemi (In re Hashemi), 104 F.3d 1122, 1125 (9th Cir.1996)). 15

1. Alleged Fraudulent and General Intent to Not Pay Subcontractors and 16 Materialman. 17

Under Plaintiffs' first theory for relief under § 523(a)(2)(A), Plaintiffs allege that 18 Debtor ran up costs for his self-benefit without the intent to pay the costs associated with 19 the Home renovation including the four subcontractors and one materialman. Plaintiffs 20 have failed to satisfy their burden of proof that Debtor had the general intent not to pay 21 expenses related to

the Home project under any of the § 523(a)(2)(A) elements. Debtor 22 did not simply run up costs, but rather, costs increased due to the difficulties of 23 renovating a 100-year-old home under the 203(k) Contract's budget constraints. Although 24 Debtor did not pay certain subcontractors or materialmen, the Court finds that all draw 25 funds went towards the Home project to Plaintiffs' benefit. Debtor was communicative 26 about the costs to Plaintiffs, although new costs arose as the project faced ongoing 27 1 problems. Merrell testified that the work completed by Coba was satisfactory under the 2 203(k) loan and without deficiencies. Also, Debtor continued to work on the project, 3 despite Plaintiffs' failure to pay amounts owing in excess of the 203(k) draws including 4 the outstanding amount of \$10,000 agreed to in the initial funding agreement. See *In re 5 Shaul*, 579 B.R. 231, 242–243 (Bankr. D. Or. 2017) (where the court found that when a 6 contractor increased the costs of the project to improve the quality of renovations, there 7 is no intent to deceive when the contractor continued to work on the project); see also *In 8 re Storer*, 380 B.R. 223, 235 (Bankr. D. Mont. 2007) (where the court did not find a debt 9 to be nondischargeable when the professional contractor–debtor obtained draw funds, 10 missed the mark with his bid, and quit because he could not complete the project). Lastly, 11 Debtor testified that after Plaintiffs fired him, he continued to contact them trying to 12 resolve differences and hoped to continue working on the Home project. Thus, under § 13 523(a)(2)(A), Plaintiffs failed to meet any of the elements pertaining to the allegation that 14 Debtor ran up costs for his self-benefit without the intent to pay the identified 15 subcontractors and materialmen. 16

2. Alleged Fraudulent Misrepresentations Related to MIS Waivers and 17 Lender's Waiver. 18 Addressing Plaintiffs' second claim for relief, Plaintiffs allege that under the 203(k) 19 Contract's draw request procedure, Debtor fraudulently misrepresented on the waivers 20 related to Draws 1 through 3 that he paid all subcontractors and materialmen before 21 receiving draw funds. The first element of this claim, whether the debtor made a 22 representation, is not disputed because Debtor acknowledges that he signed all waivers. 23 Thus, the Court considers the remaining four elements. 24 a. Debtor's Knowledge of Falsity as to the Representations Made in the MIS 25 Waivers. 26 The second element considers whether, at the time of representation, the debtor knew 27 the representation was false. The representation "must have been knowingly and 1 fraudulently made" or with gross recklessness to its truth. In *re Harris*, 3 F.4th 1339, 2 1345 (11th Cir. 2021) (citing 4 *Collier on Bankruptcy*, ¶ 523.08[1][d] (16th ed. 2018) 3 (collecting circuit and district court cases)); *In re Childers*, 651 B.R. 699, 722 (Bankr. N.D. 4 Ohio 2023). "Gross recklessness is defined as conscious indifference to the consequences 5 (of an act)." In *re Childers*, 651 B.R. at 722 (quoting *Halpin v. Hardy* (In *re Hardy*), 553 6 B.R. 613, 625 (Bankr. E.D. Ky. 2016)). 7 The language of the MIS Waivers for Draws 1 and 2 represents that the 203(k) funds 8 drawn by Debtor would be used to pay subcontractors and materialmen, not that Debtor 9 had paid the subcontractors or materialmen prior to requesting the draw funds. The 10 Court finds that based on the credible testimony of Debtor, at the time the 11 representations were made in connection to Draws 1 and 2, Debtor intended to make such 12

payments and believed that Plaintiffs would cover the shortages. Thus, there was no showing of knowledge of false representation in connection to Draws 1 and 2 at the time such representations were made. b. Debtor's Knowledge of Falsity of Representation in Lender's Waiver. In August 2023, however, when Debtor signed the Lender's Waiver, Debtor did have knowledge that his representation was false, as it was made with gross recklessness to the truth. At that time, Debtor knew that he had not paid Northwest Abatement the \$9,251.00 he had received from Draw 1, nor had he paid the window supplier and subcontractors for plumbing, electrical, and heating from Draw 3. Not only this, former employees Shane Murray, Josh Ord, and Laura Martin testified they had left Coba because Debtor informed them that funds were tight, Debtor was not able to pay subcontractors and suppliers on the Home and other Coba projects, and certain subcontractors and materialmen had not yet been paid the amounts owed to them. Nonetheless, Debtor signed Lender's Waiver representing that all subcontractors and materialmen "have been paid all amounts" on the Home project. His representation in Lender's Waiver was a conscious indifference to the consequences of his act, and thus made with gross recklessness to its truth. Plaintiffs have established that Debtor knew his representation in Lender's Waiver was false when made. c. Debtor's Intent to Deceive under Draw 3 Was Shown under the Totality of 6 Circumstances Due to His Reckless Disregard for the Truth. The third element requires Plaintiffs to show that Debtor made the false representation with the intent to deceive. Because direct evidence of the intent to deceive is rarely available, "the intent to deceive can be inferred from the totality of the circumstances, including reckless disregard for the truth." *Gertsch v. Johnson & Johnson, 11 Fin. Corp. (In re Gertsch), 237 B.R. 160, 167-68 (9th Cir. BAP 1999)*. A bankruptcy court may find requisite intent "from a debtor's reckless indifference to or disregard of the truth." *In re Khalil, 379 B.R. 163, 174-75 (9th Cir. BAP 2007)* (discussing intent to deceive in the context of § 727(a)). However, recklessness alone does not equate to fraudulent intent; it is only probative of intent. *Id.* at 174. "The essential point is that there must be something about the adduced facts and circumstances which suggest that the debtor intended to deceive" the creditor. *Id.* at 175. As the court noted in *In re McGuire*, the focus must be on "the totality of the circumstances and whether they create the overall impression of a deceitful debtor." *In re McGuire, 284 B.R. 481, 493 (Bankr. D. Colo. 2002)*. Here, under the totality of the circumstances, Debtor's gross negligence and disregard for the truth when signing Lender's Waiver under Draw 3 constituted a fraudulent misrepresentation. Debtor, at the time of making the Draw 3 request, had direct knowledge that the Home project was extremely costly, and he was aware of the consistent pattern of shorted draws and unpaid subcontractors like Northwest Abatement. The Court interprets Lender's Waiver language to apply only to labor and materials provided under the 203(k) Contract, not labor or materials outside of the 203(k) Contract. 1 Abatement. Per draw, Coba was shorted tens of thousands of dollars, and Lender only disbursed funds pursuant to the 203(k) Contract's line-item thresholds. Also, Debtor had direct knowledge that the contingency was nearly exhausted

by Draw 1, or at least by

4 Draw 2, because of the Home's expenses. Debtor did not use the 203(k) Contract's draw 5 funds to pay the four subcontractors and one materialman, although the 203(k) Contract 6 funds were applied to the Home project. Nonetheless, Debtor obtained funds by 7 fraudulent misrepresentation with direct knowledge that he could not pay certain 8 subcontractors and materialmen or catch up to the project's expenses because of Lender's 9 constant shorted draws over four months and Plaintiffs' failure to make up such 10 shortages. Therefore, under the totality of circumstances, Debtor's disregard for the truth 11 when signing Lender's Waiver to obtain the Draw 3 funds constituted an intent to 12 deceive, meeting this element. 13 d. Plaintiffs Justifiably Relied on Debtor's False Representation in Lender's 14 Waiver. 15 Fourth, a creditor must have relied on the false representations by the debtor. A party 16 does not need to prove that the reliance was reasonable. *Citibank v. Eashai*, 87 F.3d 1082, 17 1090 (9th Cir. 1996). Rather, reliance requires a less demanding level of justifiable 18 reliance on a debtor's misrepresentation. *Field v. Mans*, 516 U.S. 59, 73–75, 116 S. Ct. 19 437, 445–46, 133 L. Ed. 2d 351 (1995). This standard depends upon the knowledge and 20 experience of the person to whom the representations were made. In *re Storer*, 380 B.R. 21 at 232. The qualities and characteristics of a particular plaintiff, and the circumstances 22 of the particular case, are considered rather than of the application of a community 23 standard of conduct to all cases. In *re Shaul* 579 B.R. at 243; *Field*, 516 U.S. at 71, 116 S.

24 Ct. at 444. The Supreme Court further explained:

25 [A] person is "required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to 26 him if he had utilized his opportunity to make a cursory examination or investigation. Thus, if one induces another to buy a horse by representing 27 it to be sound, the purchaser cannot recover even though the horse has 1 but one eye, if the horse is shown to the purchaser before he buys it and the slightest inspection would have disclosed the defect. On the other 2 hand, the rule stated in this Section applies only when the recipient of 3 the misrepresentation is capable of appreciating its falsity at the time by the use of his senses. Thus, a defect that any experienced horseman would 4 at once recognize at first glance may not be patent to a person who has had no experience with horses." 5 *Id.* (citing *Restatement (Second) of Torts* § 541 cmt. a (1977)). Although one cannot close 6 his eyes and blindly rely, mere negligence in failing to discover an intentional 7 misrepresentation is no defense to fraud. In *re Apte*, 96 F.3d 1319, 1322 (9th Cir. 1996). 8 Plaintiffs justifiably relied on Debtor's fraudulent misrepresentation in Lender's 9 Waiver. Under the standard set forth in *Field v. Mans*, Plaintiffs had scant construction 10 or home renovation knowledge. Plaintiffs slowly learned through the first two draws of 11 the Home renovation process that Coba would pay subcontractors and materialmen after 12 draws had been made. When Mr. Hale asked Debtor whether he paid the subcontractors, 13 Debtor either affirmed that he did or he assured Plaintiffs that all subcontractors would 14 be paid the amounts owed to them. There was no testimony that

prior to or at the time 15 of Draw 3, Plaintiffs had knowledge that certain subcontractors or materialmen had not 16 been paid. Further, the evidence establishes that Plaintiffs, mere customers, did not 17 display the characteristics of knowledge in construction or renovations. Plaintiffs were 18 also preoccupied by Mrs. Hale's breast cancer and chemotherapy treatment. Considering 19 the Plaintiffs' minimal knowledge of construction and the 203(k) Contract procedure, and 20 Mrs. Hale's ongoing cancer treatment, Plaintiffs justifiably relied on Debtor's grossly 21 negligent false representation when Debtor represented through Lender's Waiver that 22 all subcontractors and materialmen had been paid for work performed on the Home. 23 e. Plaintiffs Have Failed to Establish Damages in Excess of Amounts Owed to 24 Coba, and the § 523(a)(2)(A) Claim Fails. 25 The creditor must establish that a claim sought to be discharged arose from an injury 26 proximately resulting from his or her reliance on a representation that was made with 27 1 the intent to deceive. In re Storer, 380 B.R. at 232 (citing Britton v. Price (In re Britton), 2 950 F.2d 602, 604 (9th Cir.1991)). Proximate cause is sometimes said to depend on 3 whether the conduct has been so significant and important a cause that the defendant 4 should be legally responsible. In re Britton, 950 F.2d at 604 (citing W. Page Keeton et al., 5 Prosser and Keeton on The Law of Torts § 42 at 273 (5th ed. 1984)). 6 Proximate cause under § 523(a)(2)(A) requires a finding by the bankruptcy court that 7 there was (1) causation in fact, or in other words, that the debtor's misrepresentations or 8 fraud was a substantial factor in determining the course of conduct that results in loss, 9 and (2) legal causation, which requires the creditor's loss to reasonably be expected to 10 result from the reliance. Sharfarz v. Goguen (In re Goguen), 691 F.3d 62, 70-71 (1st Cir. 11 2012). A plaintiff must show the "specific money or property" a debtor obtained by fraud 12 that resulted in a loss to plaintiff. In re Carlson, 426 B.R. 840, 857 (Bankr. D. Idaho 2010). 13 The evidence shows that the sole source of damages for any misrepresentation under 14 the 203(k) Contract arises out of the agreements between Plaintiffs and Coba to 15 rehabilitate the Home. As such, to establish damages under § 523(a)(2)(A), Plaintiffs 16 must prove that they have been damaged when considering all services performed and 17 payments made in the context of Phase 1. While Plaintiffs argued that Debtor and Coba 18 assumed the risk for expenses accrued outside of the 203(k) Contract budget, the Court 19 finds that the 203(k) Contract did not prohibit Debtor from performing work outside the 20 203(k) Contract. Nor did it require that all work on the Home be strictly within the 203(k) 21 Contract budget. Further, the credible testimony established that it was not possible to 22 follow the constrained budget under the 203(k) Contract considering the scale of 23 remodeling a 100-year-old home and the time constraints Plaintiffs imposed. Plaintiffs 24 and Merrell were aware of Debtor's forewarnings about the insufficiency of funds, as well 25 as the significant shortfall for work performed. Although costs were increasing and the 26 budget was changing, Debtor provided invoices to Plaintiffs and communicated with them 27 about catching Debtor up on payments owed to Coba. The Court finds that Plaintiffs' 1 argument that Debtor and Coba assumed the risk for expenses accrued outside of the 2 203(k) Contract's limited scope to be disingenuous at best. 3 With respect

to damages, the Court finds that Plaintiffs established that Debtor 4 failed to use funds received in Draw 1 to pay Northwest Abatement \$9,251.00 for asbestos 5 abatement completed under the 203(k) Contract and that Debtor failed to use funds 6 received in Draw 3 to pay \$21,655.04 to subcontractors and materialmen for work 7 performed under the 203(k) Contract as follows: \$7,700.00 for electrical; \$8,272.50 for 8 plumbing; \$4,820.00 for heating; and \$862.54 for window materials, for a total of 9 \$30,906.04. Nonetheless, Plaintiffs' claims at trial¹⁵ are less than the \$70,000 still owed 10 to Coba for work performed on the Home, and the Court holds that under the recoupment 11 doctrine as more fully discussed below, Plaintiffs have failed to establish the necessary 12 element of damages to prevail on their claim for relief under § 523(a)(2)(A). 13 Recoupment has been described as "the ancestor of the compulsory counterclaim and 14 setoff of the permissive counterclaim." *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 975 F.3d 926, 934 (9th Cir. 2020) (citing *Coplay Cement Co. v. Willis & Paul Grp.*, 983 F.2d 16 1435, 1440 (7th Cir. 1993)). Recoupment, in the bankruptcy context, has been defined as 17 the setting up of a demand arising from the same transaction as the plaintiff's claim or 18 cause of action, strictly for the purpose of abatement or reduction of such claim. *Newbery 19 Corp.*, 95 F.3d at 1399 (emphasis added).¹⁶ Furthermore, according to Black's Law 20 Dictionary, recoupment is right of a defendant to have the plaintiff's claim reduced or 21 eliminated because of the plaintiff's breach of contract or duty in the same transaction. 22 RECOUPMENT, Black's Law Dictionary (12th ed. 2024); see also EQUITABLE 23 15 During trial Plaintiffs asserted through Plaintiffs' Exhibit 113 that their maximum damages totaled 24 \$66,619.96. 16 The defining characteristic of setoff, in comparison to recoupment, is that in a setoff, "the mutual 25 debt and claim ... are generally those arising from different transactions." *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 975 F.3d at 933 (citing *Newbery Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1398 (9th Cir. 26 1996)) (emphasis added). 27 1 RECOUPMENT, Black's Law Dictionary (12th ed. 2024) (A principle that diminishes a 2 party's right to recover a debt to the extent that the party holds money or property of the 3 debtor to which the party has no right). 4 One significant difference between setoff and recoupment is that in the fight between 5 reciprocal obligations, the doctrine of setoff is offensive in nature and can result in an 6 affirmative judgment in favor of the party to whom the greater obligation is owed. *In re 7 Thomas*, 529 B.R. 628, 637 (Bankr. W.D. Pa. 2015). Alternatively, recoupment is an 8 affirmative defense, and this equitable doctrine merely seeks to adjust downward the 9 amount of the plaintiff's demand in light of the reciprocal demand of the defendant. *Id.* 10 at 638; see e.g., *Anthem Life Ins. Co. v. Izaguirre (In re Izaguirre)*, 166 B.R. 484, 490–93 11 (Bankr. N.D. Ga. 1994). 12 In addressing whether the countervailing claims or rights asserted by the creditor 13 arise from the same transaction or occurrence under the doctrine, the Ninth Circuit has 14 "held that the crucial factor . . . is the 'logical relationship' between the two." *In re 15 Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 975 F.3d at 934 (9th Cir. 2020) (citing *In re TLC 16 Hosps., Inc.*, 224 F.3d 1008, 1012 (9th Cir. 2000)). Most recently, the Ninth Circuit 17 reiterated: 18 The test remains whether the relevant rights being asserted against the debtor are

sufficiently logically connected to the debtor's countervailing obligations 19 such that they may be fairly said to constitute part of the same transaction. 20 *Sims*, 224 F.3d at 1012; *Newbery*, 95 F.3d at 1401-02. 21 *Gardens Reg'l Hosp.*, 975 F.3d at 924. In applying this standard, "courts have permitted 22 a variety of obligations to be recouped against each other, requiring only that the 23 obligations be sufficiently interconnected so that it would be unjust to insist that one 24 25 party fulfill its obligation without requiring the same of the other party." *Id.* (quoting 5 26 *Collier*, *supra*, ¶ 553.10[1]). 27 The Supreme Court in *Moore* held that a "[t]ransaction" is a word of flexible meaning. 1 It may comprehend a series of many occurrences, depending not so much upon the 2 3 immediateness of their connection as upon their logical relationship." *In re Madigan*, 270 4 B.R. 749, 755 (9th Cir. BAP 2001) (quoting *Moore v. New York Cotton Exchange*, 270 U.S. 5 593, 610, 46 S. Ct. 367, 70 L. Ed. 750 (1926)); see also *Albright v. Gates*, 362 F.2d 928, 929 6 (9th Cir. 1966); *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 975 F.3d at 934; *Newbery*, 95 7 8 F.3d at 1402. The Ninth Circuit also cautioned that "the 'logical relationship' concept is 9 not to be applied so loosely that multiple occurrences in any continuous commercial 10 relationship would constitute one transaction," *Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 11 975 F.3d at 934; *In re TLC Hosps., Inc.*, 224 F.3d at 1012. 12 Here, Debtor raised as a defense to Plaintiffs' claim for damages that Cobra was still 13 14 owed more than \$70,000 at the time he was fired. The Court must determine whether the 15 logical relationship test is met between Plaintiffs' claim for damages and Debtor's and 16 Cobra's defense claim for unpaid work. Looking at the totality of the record, the Home 17 project's Phase 1 was a single transaction from which Debtor's and Plaintiffs' claims 18 arose. Phase 1 was comprised of the 203(k) Contract, the initial funding agreement, and 19 20 the necessary work outside of the 203(k) Contract, which was contemplated by the 21 parties. All agreements were a series of occurrences that logically connect to Phase 1's 22 completion, and all the work thereunder was performed during the same time period. 23 Debtor and former Cobra employees also understood Phase 1 to have parallel paths. 24 Additionally, all work performed for Phase 1 was invoiced together by Cobra. Because all 25 26 work, whether under contracts or supplemental to them, was incorporated and 27 intertwined for the common goal of completing Phase 1—a single transaction—Plaintiffs' 1 claim for damages under the 203(k) Contract is logically related to Cobra's recoupment 2 3 defense based on unpaid work done on the Home outside the contracts. 4 Having determined that Cobra's recoupment defense is logically related to Plaintiffs' 5 claim for nondischargeable damages under the 203(k) Contract, the Court concludes that 6 the equitable recoupment doctrine should be applied in this instance, as it would be 7 8 unjust for Plaintiffs to retain the benefit of Debtor's and Cobra's work on the Home without 9 paying for it. The Court also finds that based on the evidence in the record, Cobra is owed 10 at least \$70,000 for work performed on the Home in Phase 1, outside the 203(k) Contract 11 and initial funding agreement, which was contemplated by the parties. Accordingly, 12 because Plaintiffs owe more for work performed on the Home in Phase 1 than Debtor owes 13 14 on its nondischargeable debt arising out of the 203(k) Contract, and all damages Plaintiffs 15 seek arise

out of Cobra's work on the Home, the Court finds that Plaintiffs are not entitled to any damages. The Court recognizes that the Ninth Circuit has ruled that equitable remedies, such as recoupment, may not be invoked to compensate someone who has engaged in inequitable conduct. *Cooper v. Soc. Sec. Admin.*, 131 F.4th 995, 1011 (9th Cir. 2025); *Aalfs v. Wirum* (In re Straightline Investments, Inc.), 525 F.3d 870 (9th Cir. 2008). Generally, a person seeking equitable relief must have clean hands. In re Pac. Nw. Storage LLC Income 386 B.R. at 776 (citing *Investors v. Shelton*, 3 Wash.2d 599, 602, 101 P.2d 973, 974 (1940)). The Supreme Court has emphasized, however, that the doctrine of unclean hands "does not mean that courts must always permit a defendant wrongdoer to retain the profits of his wrongdoing merely because the plaintiff himself is possibly guilty of transgressing the law." *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 960 (9th Cir. 2015) (quoting *Johnson v. Yellow Cab Transit Co.* 321 U.S. 383, 387, 64 S. Ct. 622, 624–25, 88 L. Ed. 814 (1944)). More so, *Northbay Wellness Grp., Inc.* states "[r]ather, in determining whether the doctrine of unclean hands precludes relief requires balancing the alleged wrongdoing of the plaintiff against that of the defendant, and 'weigh[ing] the substance of the right asserted by [the] plaintiff against the transgression which, it is contended, serves to foreclose that right.'" *Northbay Wellness Grp., Inc.*, 789 F.3d at 960 (citing *Republic Molding Corp. v. B.W. Photo Utils.*, 319 F.2d 347, 350 (9th Cir. 1963)). The "clean hands doctrine should not be strictly enforced when to do so would frustrate a substantial public interest." *EEOC v. Recruit U.S.A., Inc.*, 939 F.2d 746, 753 (9th Cir. 1991); see also *Northbay Wellness Grp., Inc.* 789 F.3d at 960 (where the Ninth Circuit reversed the bankruptcy court because it failed to conduct the balancing test and weigh the parties' respective wrongdoing, which was an error of law that abused discretion). Balancing the finding of Debtor's false representations under § 523(a)(2)(A) with Plaintiffs' retention of the reasonable value of services for unpaid work on their Home, the Court finds that the equities weigh in favor of allowing Debtor and Cobra to recoup the nondischargeable damages. To support this finding, the Court again emphasizes the following: Merrell's approval when inspecting the Home; Debtor's completed work that was consistent with what the 203(k) Contract required; Plaintiffs' failure to remit \$10,000.00 to Debtor and Cobra as initial funds to supplement the insufficient 203(k) budget; Plaintiffs' acknowledgement of invoices and their communication with Debtor about catching him up on payments; the credible testimony of several witnesses, including Debtor; Shane Murray's testimony that all work performed, including the work not contracted for, was necessary to complete Phase 1 concerning the Home's structure and safety; Debtor's good faith effort in attempting to address the structural needs of renovating the 100-year-old Home; and Debtor's willingness to continue working despite the significant short falls and Plaintiffs' nonpayment of amounts owing to Cobra under the initial funds agreement. The Court holds that the balancing test set forth in *Northbay Wellness Group* weighs in favor of Debtor, and Debtor's false misrepresentation under § 10 523(a)

(2)(A) is not a basis to preclude recoupment. 11 In conclusion, Plaintiffs' claim for relief under § 523(a)(2)(A) is denied based on 12 Plaintiffs' failure to prove damages. 13 14 F. Plaintiffs' Attorney is Not Entitled to Recover Prepetition Attorney's Fees 15 under the 203(k) Contract or Lender's Waiver Language. 16 Plaintiffs' attorney seeks attorney's fees pursuant to the 203(k) Contract and Lender's 17 Waiver. Section 3 of the 203(k) Contract states: 18 19 The contractor will indemnify and hold harmless the owner from and against all claims, damages, losses, expenses, legal fees or other costs 20 arising or resulting from the contractor's performance of the work or provisions of this section . . . The contractor is responsible for, and 21 indemnifies the [o]wner against, acts and omissions of employees, subcontractors and their employees, or others performing the work under 22 this [a]greement with the contractor. 23 Pls.' Ex. 1:2. Section 9 of the 203(k) Contract states: 24 Final payment will be due after complete release of any and all liens arising out of the contract or submission of receipts or other evidence of 25 payment covering all subcontractors or suppliers who could file such a 26 lien. The contractor agrees to indemnify the [o]wner against such liens 27 and will refund all monies including costs and reasonable attorney's fees 1 paid by the owner in discharging the liens. 2 Pls.' Ex. 1:3. Lastly, Lender Waiver's states that the contractor: 3 hereby agrees unconditionally to indemnify [b]orrower and hold [b]orrower harmless from and against all liability, loss, cost, or expense 4 (including, but not limited to attorney's fees) now or hereafter incurred, paid, or suffered by or asserted against [b]orrower or any of [b]orrower's 5 property because of any claim or action by [c]ontractor with respect to the 6 claims, liens, and rights herein waived and released or arising out of any breach or untruth of any warranty of representation made. 7 Pls.' Ex. 55. These are the only contractual attorney's fees provisions Plaintiffs' attorney 8 points to for a claim of trial related attorney's fees. 9 There is no general right to recover attorney's fees under the Bankruptcy Code. 10 *Renfrow v. Draper*, 232 F.3d 688, 693 (9th Cir. 2000). Here, Plaintiffs cannot obtain 11 attorney's fees under the 203(k) Contract, Lender's Waiver, or any fees related to the 12 adversary proceeding. While it is undisputed that a lien on Plaintiffs' Home was filed by 13 Northwest Abatement in the amount of \$33,600.00, and that Debtor did not pay four 14 subcontractors and one materialman, the Court holds that Plaintiffs are not entitled to 15 attorney's fees for the following three reasons. 16 First, Plaintiffs' statement of damages did not list any attorney's fees for the 17 prepetition lien removals or actions against Plaintiffs relating to the Home project. The 18 Court finds that damages pertaining to these attorney's fees should have been clearly 19 listed in the Plaintiffs' statement of damages as pretrial damages incurred by Plaintiffs 20 in connection with Debtor's representation concerning the payments of certain 21 subcontractors or materialmen. See generally Pls.' Ex. 113. 22 Second, all the fee provisions are narrow in that they provide only that Debtor will 23 indemnify Plaintiffs for lien removal or third-party actions against them relating to work 24 on the Home within the 203(k) Contract's scope. The cited provisions do not provide the 25 right to attorney's fees generally for litigating breach of state law contracts between 26 27 1 Plaintiffs and Debtor, or nondischargeability claims. Nor do they contain a prevailing 2 party provision under

RCW 4.84.330. 3 Third, even if there was a prevailing party provision, the Court holds that based on 4 its ruling, Plaintiffs are not a prevailing party. Therefore, Plaintiffs' claims for attorney's 5 fees under the 203(k) Contract or Lender's Waiver are denied.

6 IV. CONCLUSION

7 Plaintiffs' claims for relief under § 523(a)(2)(A) are denied based on Plaintiffs' failure 8 to establish the essential elements of such claims. Additionally, Plaintiffs' claims for 9 attorney's fees are denied. 10 / / / End of Memorandum Decision / / / 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27