

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF COLORADO

In re:	)	
	)	
Jeffrey Edward Musgrave,	)	
dba J&M Construction, mem. J&M	)	
Construction, LLC & Maria Musgrave	)	Case No. 08-25165-SBB
	)	
SSN: XXX-XX-8002; XXX-XX-7336	)	Chapter 7
	)	
Debtors.	)	

DELMY HERNANDEZ, dba PANCHO'S	)	
MEXICAN RESTAURANT	)	
	)	
Plaintiff,	)	Adversary Case No.
	)	09-01006-SBB
v.	)	
	)	
JEFFREY EDWARD MUSGRAVE,	)	
dba J&M CONSTRUCTION, mem. J&M	)	
CONSTRUCTION, LLC, & MARIA	)	
MUSGRAVE, mem. J&M CONSTRUCTION,	)	
LLC	)	
	)	
Defendant.	)	

**MEMORANDUM OPINION AND ORDER**

This adversary proceeding to determine the dischargeability of a debt came before the Court for trial on April 1, 2010. The Plaintiff, Delmy Hernandez, dba Pancho's Mexican Restaurant ("Hernandez") filed several claims pursuant to 11 U.S.C. §523(a)(4) and (a)(6) against the debtors, Jeffrey Edward Musgrave, dba J&M Construction, LLC, and Maria Musgrave (hereinafter collectively referred to as "the Musgraves"). After due consideration of the record on file, including the parties' stipulations of fact, as well as the testimony and evidence presented at trial, the Court hereby enters its Findings of Fact and Conclusions of Law.

This Court ruled from the Bench at the conclusion of the trial and, in an abbreviated fashion, articulated its findings of fact and conclusions of law and ruled in favor of the Plaintiff and against the Defendants and each of them. The Court requested that Plaintiff's counsel submit proposed findings of fact and conclusions of law reflecting the oral ruling from the Bench and incorporating all its features and components. The Court hereby adopts and incorporates its ruling from the Bench and supporting conclusions and findings herein as the final Order and entry of Judgment.

### FINDINGS OF FACT

1. Plaintiff, Delmy Hernandez, owns and operates Pancho's Mexican Restaurant located at 16427 Victor Street, Victorville, California 92395.
2. The Musgraves commenced this Chapter 7 bankruptcy case (Case No. 08-25165-SBB) on September 30, 2008, by filing a joint Voluntary Petition pursuant to Chapter 7 of the Bankruptcy Code, 11 U.S.C. §101 et. seq.
3. Hernandez is a creditor of Musgrave and has standing to bring this action pursuant to 11 U.S.C. § 523.
4. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I), and this Court has jurisdiction over this action pursuant to 28 U.S.C. § 1334.
5. Venue is proper in the United States Bankruptcy Court for the District of Colorado pursuant to 28 U.S.C. §§ 1408-1409.
6. At all material times to this action, Jeff Musgrave was the sole owner and member/manager of J&M Construction, L.L.C. ("J&M"). J&M was formed on February 20, 2007 as a California limited liability company. As of November 24, 2008, the California Secretary of State's website has listed the current status of J&M as "canceled."
7. At all material times to this action, J&M conducted its business activities in the State of California, where it held a valid California General Contractor's License No. 860842, according to the California Contractors State License Board website.
8. As the sole member and manager of J&M, Jeff Musgrave was responsible for directing the management of monies paid to J&M and the payment of J&M's debts.
9. In April, 2007, Hernandez contracted with J&M to construct improvements and make additions to Pancho's Mexican Restaurant (hereinafter "the construction project").
10. At all times material to this case, Jeff Musgrave was acting as a corporate officer or agent of J&M and his acts were performed within the course and scope of his employment by J&M.
11. The original contract price for the construction project was increased by various amounts as the result of change orders dated June 5, 2007, June 15, 2007, August 2, 2007, September 11, 2007, November 26, 2007, November 29, 2007, April 1, 2008, April 14, 2008, April 30, 2008, and June 25, 2008.
12. The written contract dated July 31, 2008 for the total contract price of \$216,430.74 is the final, "updated" contract between the parties, and this updated contract price included the amounts

attributable to the change orders referenced above.

13. Hernandez made all payments due and owing to Jeff Musgrave under the contract, for a total of \$216,430.74.

14. Jeff Musgrave directed Hernandez to make all payments under the contract to him personally, not to J&M, and documented this request in the parties' written construction contract.

15. Jeff Musgrave directed Hernandez to make all payments under the contract in the form of cashiers checks, and to divide large payments into multiple cashiers checks.

16. Jeff Musgrave received a total of twenty-two (22) separate cashiers checks from Hernandez as payment from Hernandez for the construction project from August 28, 2007, through August 1, 2008.

17. Jeff Musgrave signed a Conditional Waiver and Release upon Final Payment dated July 31, 2008, verifying that he had been paid in full by Hernandez for the construction project.

18. J&M hired subcontractors Medrano's Paving Company (which in turn subcontracted with Blue Diamond Materials, Hi-Grade Materials Co., Regional Materials and Maurice Thompson Concrete), Fireman's Design and Landscaping, Baja Drywall Inc., and Vern's Glass to supply services, labor, materials, or equipment for the construction project.

19. With regard to paving work for the construction project, J&M has failed to pay to Medranos and the related subcontractors the total sum of \$40,157.90.

20. J&M has failed to pay the amounts due and owing to its subcontractor, Fireman's Design and Landscaping.

21. J&M has failed to pay the amount due and owing of \$2,680 to its subcontractor, Baja Drywall.

22. Subcontractor Medrano's Paving, and the related subcontractors of Blue Diamond Materials, Hi-Grade Materials, and Maurice Thompson Concrete, filed liens on Hernandez' property because J&M failed to pay them for the work and/or materials that they provided for the construction project.

23. Neither J&M nor Musgrave maintained any bookkeeping records for the construction business, nor did they engage a bookkeeper or accountant to maintain any such records on their behalf, from April, 2007 through August, 2008, during the pendency of the construction project.

24. The only bank accounts which Musgrave or J&M listed on their Voluntary Bankruptcy Petition were accounts xxx7495 and xxx9447 at Mountain Valley Bank, 400 Main Street, P.O. Box 718, Meeker, CO 81641 and accounts xxx5381 (personal account) and xxx9778 (business account) at Arrowhead Credit Union.

25. Of the 22 total cashiers checks that he received as payment from Hernandez for the construction project from August 28, 2007, through August 1, 2008, Jeff Musgrave deposited two (2) into his personal bank account at Arrowhead Credit Union, #xxx5381; eleven (11) into his business account at Arrowhead Credit Union, #xxx9778; and he has no record of depositing the remaining nine (9) cashiers checks.

26. Jeff Musgrave's wife, Maria Musgrave, moved to Meeker, Colorado in February, 2008, where she obtained employment as a bank teller at the local Mountain Valley Bank. Jeff Musgrave continued to reside in California and work in his construction business until August, 2008.

27. Jeff and Maria Musgrave purchased a single family residence at 1040 Garfield St., Meeker, CO on March 20, 2008, with a purchase money loan from the local Mountain Valley Bank.

28. Jeff and Maria Musgrave opened various personal bank accounts at the local Mountain Valley Bank in Meeker, CO in 2008, including accounts xxx7410, xxx7411, xxx7520, xxx9447, and xxx7495.

29. The Defendants were insolvent at the time they filed for bankruptcy, and in 2008 prior to the bankruptcy filing.

30. On July 30, 2009, the Contractors State License Board for the State of California recommended to the California Attorney General that legal action be taken against the Defendants for their conduct with regard to the construction project, specifically for abandoning the construction project without legal excuse; departing from trade standards; exceeding the contract amount; failing to pay for materials or services and failing to timely pay subcontractors. J&M and Jeff Musgrave did not participate in this proceeding.

31. With regard to the credibility of witnesses who testified at trial, the Court finds that the Plaintiff, Hernandez, was an extremely credible witness. In addition, the contractor who testified on behalf of the Plaintiff, Bob Carlucci, was a very credible witness, and the exhibits referenced during his testimony reinforced the accuracy and credibility of his recitals.

32. By contrast, the credibility of the Defendant, Jeff Musgrave, was extremely poor. As one example among many, his testimony regarding the reason for demanding a single payment be divided into six separate cashiers checks in amounts less than \$10,000 was absurd and defied all logic, reason and common sense.

33. Although the Complaint does not specifically allege a violation of 11 U.S. C. §523(a)(2), the Court finds that the elements of common law fraud were satisfied, in that Jeff Musgrave knowingly and intentionally made false statements with the intention of deceiving Hernandez and to induce her to turn over the contract payments of approximately \$215,000, and that Hernandez reasonably and justifiably relied upon these misrepresentations to her substantial

detriment. *See* Bankruptcy Rule 7015 (applying Rule 15(b) to adversary proceedings, which provides in pertinent part that when issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings”).

34. These false statements include, without limitation, the following:

- a. Jeff Musgrave falsely represented to Hernandez that he would pay and had paid the subcontractors when, in fact, he had not done so and had no present intention of doing so. Although Jeff Musgrave may have paid some of the subcontractors in small part, he did not pay them in good measure or in any substantial amount.
- b. Jeff Musgrave falsely represented to Hernandez that he and J&M would continue conducting the construction business in California when, in fact, he had every intention of moving himself, his family and his business to Colorado and no intention of remaining in business in California. The evidence further established that Jeff Musgrave had been planning to move to Colorado since at least approximately October of 2006, when he made his initial contact with Bruce Clatterbaugh at Mountain Valley Bank in Meeker, Colorado, regarding the opening of a bank account there.
- c. Jeff Musgrave falsely represented to Hernandez that the reason he needed to be paid in the form of cashiers checks, in small denominations, was to facilitate his business and more quickly access the funds when, in fact, the record establishes that Jeff Musgrave’s goal was to effectuate invisible cash transactions and accomplish money transfers through both reported and unreported accounts.

35. The record contains overwhelming evidence of a scheme to defraud that was conceived by Jeff Musgrave and implemented by both Jeff Musgrave and Maria Musgrave, beginning before the contractual relationship with Hernandez and continuing through the date of the Musgraves’ bankruptcy filing on September 30, 2008. As set forth herein, the scheme included the naked theft and embezzlement of funds from an innocent and trusting victim, Hernandez; a pattern of deception; a breach of fiduciary duties; and willful and malicious injury. The evidence of these offenses includes, without limitation, the following acts:

- a. Jeff Musgrave had communications with Bruce Clatterbaugh, the President of Mountain Valley Bank in Meeker, Colorado, regarding his planned move to Colorado as early as October, 2006, long before he actually moved to Colorado in early August, 2008.
- b. In an effort to hide income from his construction business, in 2007 and 2008, Jeff Musgrave often immediately cashed rather than deposited the large payment checks he received from customers.
- c. Hernandez was Jeff Musgrave’s last customer in California before the planned move to Colorado. Jeff Musgrave insisted that Hernandez must make the construction contract payments to him personally, in the form of cashiers checks. This form of payment was different from the form of payment he received from his other customers.

- d. Jeff Musgrave also insisted that the cashiers checks from Hernandez must be in small denominations, and he only made immediate cash withdrawals when the cashiers checks were in amounts less than \$10,000.
- e. Of the \$215,000 that he received as payment from Hernandez for the construction project, Jeff Musgrave immediately cashed approximately \$75,000. He deposited the remainder of the cashiers checks into both business and personal checking accounts in California, and then subsequently made cash withdrawals from these two accounts which totaled over \$147,000, during the period from January through July, 2008..
- f. Jeff Musgrave made routine and casual payments to his subcontractors in cash, on a regular basis, in substantial amounts.
- g. Jeff Musgrave failed to keep appropriate books and records for his construction business and maintained no proof of payment to his subcontractors.
- h. Immediately upon receiving the last cashiers checks from Hernandez, in the first week of August, 2008, Jeff Musgrave fled from California to Colorado. Jeff Musgrave did not make full payment to most of the subcontractors for Hernandez' construction project; he did not perform or supervise the performance of the work in a workmanlike manner; and he failed to complete the project. He thereafter refused to respond to telephone calls, emails and other communications from Hernandez.
- i. Maria Musgrave moved to Colorado without her husband in February of 2008, to assist in establishing residency for the planned bankruptcy filing in Colorado which took place on September 30, 2008.
- j. Maria Musgrave obtained employment as a bank teller at Mountain Valley Bank in Meeker, Colorado, in 2008.
- k. Maria Musgrave and Jeff Musgrave opened two bank accounts in Meeker, Colorado at Mountain Valley Bank in March of 2008, in their own names and in the name of J&M.
- l. Jeff Musgrave filed for bankruptcy within 8 weeks of moving to Colorado.
- m. During the period from July, 2008 through December, 2008, Maria Musgrave and Jeff Musgrave made repeated and consistent cash deposits to their business and personal accounts, in large amounts, which were consistently under \$10,000. There is no logical or credible evidence to indicate any source of those cash funds other than the construction payments made by Hernandez.
- n. Maria Musgrave and Jeff Musgrave failed to disclose the existence of the bank account at Mountain Valley Bank, xxx7827, to their creditors, the U.S. Trustee, or anywhere on

their bankruptcy schedules.

- o. Maria Musgrave and Jeff Musgrave made a transfer of \$18,400 to the undisclosed Mountain Valley Bank account, xxx7827, in November of 2008.

36. The residence at 1040 Garfield Street in Meeker, Colorado, was purchased in March, 2008, with an acquisition loan from Mountain Valley Bank for the purchase price of \$100,000, just six months before the Musgraves filed their joint bankruptcy petition in Colorado in September of 2008. Jeff and Maria Musgrave were insolvent at the time this property was acquired, and they arranged to place title solely in the name of Maria Musgrave in an effort to shield the property from the claims of creditors, including Hernandez, and with an actual purpose to delay, hinder and defraud their creditors. In 2008, after the property was purchased and while they remained insolvent, the Musgraves thereafter invested additional funds to remodel and improve the property. The evidence admitted at trial shows that a portion of the remodeling funds, approximately \$35,000, was derived from a loan received from Mountain Valley Bank, and ultimately, on August 18, 2008, the Musgraves obtained permanent financing for the property by jointly executing a promissory note and deed of trust in favor of Mountain Valley Bank in the amount of \$135,517.95. The remainder of the remodeling funds was derived from the proceeds of the theft from Hernandez, and invested in this property with the actual intent to hinder, delay and defraud their creditors, including Hernandez. Thus, because any equity that the Musgraves have obtained in this property is the result of the fraud perpetrated upon Hernandez, the Court concludes that a constructive trust should be placed on the Musgraves' interest in this property in favor of Hernandez, subject to the existing lien rights of Mountain Valley Bank.

37. The Musgraves no longer reside in the residence at 1040 Garfield Street; they have placed it on the market for a sale price of \$185,000, and it is presently being leased to a third party in exchange for rent of \$1300 a month.

38. Jeff Musgrave treated J&M as his alter ego, using it purely as a shell and a cover for his personal activities, such that to allow Jeff Musgrave to dodge personal responsibility for its debts would be to sanction a fraud and promote an injustice.

39. As a result of the Musgraves' scheme to defraud, steal and embezzle from Hernandez, she was forced to file a Chapter 13 bankruptcy petition in California, and she is presently making payments on the mechanics lien claims filed by Musgrave's subcontractors in the amount of \$40,157.90. As a further result of this scheme, many aspects of the construction project undertaken by Musgrave were not performed or were performed in a grossly unworkmanlike manner. The uncontroverted evidence established that the sum of \$66,000 is required to repair and complete the project.

#### CONCLUSIONS OF LAW

1. Defendant Jeff Musgrave is liable to Plaintiff, Hernandez, pursuant to Claim One because he committed a fraud and a defalcation of his fiduciary duties to Hernandez, and this debt is excepted from discharged pursuant to 11 U.S.C. §523(a)(4) and (a)(6). California Calif. Bus. & Prof. Code § 7071.17 provides for the revocation of a contractor's license for failing or refusing

to pay a subcontractor or material supplier based on an unsatisfied final judgment, and that such a license may not issue, reinstate, or reactivate until the contractor files a bond sufficient to guarantee payment of an amount equal to the unsatisfied final judgment or judgments. This statute thereby recognizes a technical trust for the benefit of Hernandez and her material suppliers. *See Allen v. Romero*, 535 B.R. 618, 622 (10<sup>th</sup> Cir. 1976). As trustee under that trust, J&M and Jeff Musgrave owed Hernandez a fiduciary duty to disburse the funds received from Hernandez to the subcontractors in payment for the materials and labor purchased from the Subcontractors. In addition, under California common law, as the director of an insolvent corporation, Jeff Musgrave owed a fiduciary duty to Hernandez not to engage in self-dealing with respect to the assets of J&M. *See, e.g., In re Jacks*, 266 B.R. 728, 739-40 (9<sup>th</sup> Cir. BAP 2001). Jeff Musgrave intentionally breached these fiduciary duties by failing to account for the monies obtained from Hernandez; by failing to use these monies to pay for the materials and labor provided by the subcontractors, and by diverting these monies to the personal use of himself and Maria Musgrave. *See, e.g. In re White*, 271 B.R. 213 (10<sup>th</sup> Cir. BAP 2001); *In re Merrill*, 252 B.R. 497 (10<sup>th</sup> Cir. BAP 2000).

2. Defendant Jeff Musgrave is liable to the Plaintiff, Hernandez, for the actions of J&M pursuant to Claim Two because he treated the company as his alter ego, and the company's rights, assets and cash as his own, and it is accordingly appropriate to pierce the corporate veil of limited liability. This debt is excepted from discharge pursuant to 11 U.S.C. §523(a)(4) and (a)(6).

3. Defendants Maria Musgrave and Jeff Musgrave are liable to the Plaintiff, Hernandez, pursuant to Claim Three because they participated together in a scheme and design to accomplish a theft of Hernandez' money by wrongfully and with fraudulent intent taking hernandez' money. *See, e.g. In re Tinker*, 311 B.R. 872, 876 (Bkrcty D. Colo. 2004). This debt is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4) and (a)(6).

4. Defendants Maria Musgrave and Jeff Musgrave are liable to the Plaintiff, Hernandez, pursuant to Claim Four because they participated together in a scheme and design to accomplish the embezzlement of Hernandez' money, by fraudulently appropriating money that Hernandez had entrusted to Jeff Musgrave for the purpose of paying for the material and labor provided by the subcontractors and using it instead for their own benefit, *see, e.g., In re Tinker, supra*, and this debt is excepted from discharge pursuant to 11 U.S.C. §523(a)(4) and (a)(6).

5. Defendant Jeff Musgrave is liable to the Plaintiff, Hernandez, pursuant to Claim Five because, in a transaction which resulted in the sale of goods and services to a customer, Hernandez, he knowingly and intentionally falsely represented that the funds paid by Hernandez to Jeff Musgrave had been used to pay for the material and labor supplied by the subcontractors when, in fact, it was not, in violation of California Civil Code § 1770(a)(16), and this debt is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4) and (a)(6). In addition to actual damages, pursuant to California Civil Code § 1780(a) and (e), Hernandez is entitled to recover punitive damages, attorneys fees, costs, and such other relief as the court deems proper.

6. Defendants Jeff Musgrave and Maria Musgrave are liable to the Plaintiff, Hernandez, pursuant to Claim Six because they engaged in willful conduct and intentionally caused a malicious injury to Hernandez, without just cause or excuse, specifically aware of the financial catastrophe their actions would visit upon her. *See McCain Foods USA, Inc. v. Shore*, 317 B.R. 536, 542 (10<sup>th</sup> Cir. BAP 2004); *In re Hill*, 390 B.R. 407, 412 (10<sup>th</sup> Cir. BAP 2008). Their actions were willful because they intended to cause the consequences and/or they believed that the consequences were substantially certain to result. The injury was malicious because the Musgraves either intended the resulting injury or intentionally took action that was substantially certain to cause the injury to Hernandez. *See id.* This debt is excepted from discharge pursuant to 11 U.S.C. § 523(a)(6).

7. The equitable remedy of a constructive trust is available under both California and Colorado law to prevent unjust enrichment and enable the restitution of property that does not in equity and good conscience belong to the Defendants. *See, e.g., Habitat Trust for Wildlife, Inc. v. City of Rancho Cucamonga*, 96 Cal. Rptr. 3d 813 (4<sup>th</sup> DCA 2009); *Kerns v. Kerns*, 53 P.3d 1157, 1164 (Colo. 2007). The Court concludes that the Musgraves' interest in the property at 1040 Garfield in Meeker, Colorado, was acquired under such circumstances that the holder of legal title may not in good conscience retain the beneficial interest. Accordingly, the Court imposes the equitable device of a constructive trust to compel Maria Musgrave to convey all right, title and interest in the subject property to the Plaintiff, Hernandez, by execution of a quitclaim deed in Hernandez' favor within 7 days of the date of this Order. This judgment is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4) and (a)(6).

8. The amount of actual damages sustained by the Plaintiff, Hernandez, as a result of the Musgraves' wrongful conduct is \$ 106,157.90, consisting of the amount of debt owed to the unpaid contractors who have filed liens of Hernandez' property, \$40, 157.90, together with the amount required to repair and complete the defective and incomplete work that J&M and Jeff Musgrave were paid to perform, \$66,000.

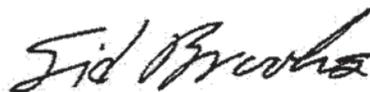
9. The Court concludes that there is clear and convincing evidence that both Defendants Jeff Musgrave and Maria Musgrave "have been guilty of oppression, fraud or malice" such that the Plaintiff, Hernandez, may recover exemplary damages in addition to actual damages pursuant to California Civil Code § 3294, for the sake of example and by way of punishing the Defendants. In particular, these Defendants have engaged in "despicable conduct that subjected a person to cruel and unjust hardship in conscious disregard of that person's rights." *Id.* at §3294(c)(2). An award of punitive damages under state law is part of the nondischargeable debt. *See Cohen v. De la Cruz*, 523 U.S. 213, 216-19 (1998).

10. Accordingly, the Court has determined that, in light of all the circumstances attendant to the Musgraves' wrongful conduct in this case, including the amount of attorneys fees that Hernandez has been required to expend as a direct result of the wrongs visited upon her, both in this case and in the separate bankruptcy proceeding in California, an appropriate amount of punitive damages to be awarded is \$53,078.95. In view of the amount of this award, the Court declines to enter an additional award of attorneys' fees pursuant to Claim Five.

11. Thus, the total amount of the judgment due and owing to Plaintiff from the Defendants

Jeffrey and Maria Musgrave is \$159,236.85, plus interest at the federal statutory rate pursuant to 28 U.S.C. § 1961, and costs in an amount to be determined and hereafter taxed as costs.

DONE and ORDERED this ~~20~~<sup>21</sup> day of April, 2010.



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SIDNEY B. BROOKS  
UNITED STATES BANKRUPTCY JUDGE

cc: counsel of record