

So Ordered.

Dated: March 31, 2021



Katherine M. Perhach

Katherine Maloney Perhach
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:
Brody Coates and
Kristin Coates,

Debtors.

Chapter 7

Case No. 19-29067-kmp

Crescent Electric Supply Company,
Plaintiff,

v.

Adv. No. 19-2211

Brody Coates,

Defendant.

**DECISION AND ORDER DENYING CRESCENT ELECTRIC SUPPLY COMPANY'S
MOTION FOR SUMMARY JUDGMENT**

Crescent Electric Supply Company ("Crescent") has brought this adversary proceeding seeking a nondischargeable judgment against Debtor Brody Coates for fraud or defalcation while acting in a fiduciary capacity pursuant to 11 U.S.C. § 523(a)(4). Crescent alleges that Mr. Coates breached his fiduciary duties under Wisconsin's theft-by-contractor statute, Wis. Stat. § 779.02(5), and the resulting debt is therefore nondischargeable under 11 U.S.C. § 523(a)(4). Crescent alleges that it supplied electrical materials, fixtures, and other supplies to Coates

Electric, LLC in the total amount of \$48,557.34 for three projects, SBM Watertown, Pizza Ranch, and Mary's Custom Storage, that the owner or general contractor paid Coates Electric, as their electrical subcontractor, for those materials, but that Coates Electric did not pay its supplier, Crescent. After filing a construction lien against the Pizza Ranch, Crescent recouped \$15,000. Consequently, Crescent seeks a nondischargeable judgment against the Debtor, the sole owner of Coates Electric, for its actual damages of \$33,557.34, plus treble damages of \$100,672.02 pursuant to Wisconsin's theft-by-contractor statute, or in all, \$134,229.36, plus attorneys' fees and costs, also pursuant to Wisconsin's theft-by-contractor statute. Crescent has moved for summary judgment asserting that there are no genuine issues of material fact and that Crescent is entitled to judgment as a matter of law. For the reasons stated below, Crescent's Motion for Summary Judgment is denied.

Statement of Jurisdiction

The Court has jurisdiction over the Motion pursuant to 28 U.S.C. § 1334 and the order of reference from the district court pursuant to 28 U.S.C. § 157(a). *See* Order of Reference (E.D. Wis. July 10, 1984) (available at www.wied.uscourts.gov/gen-orders/bankruptcy-matters) (last accessed March 31, 2021). As a proceeding to determine the dischargeability of a debt, this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I) and the Court may enter a final judgment pursuant to 28 U.S.C. § 157(b)(1). Crescent's Complaint consented to entry of a final order as to its theft-by-contractor claim and Mr. Coates' answer did the same. Complaint, Docket No. 1 at ¶ 4; Answer, Docket No. 5 at ¶ 4.

Summary Judgment Standard

Summary judgment is only appropriate "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed.

R. Civ. P. 56(a); Fed. R. Bankr. P. 7056. At the summary judgment stage, the role of the court is not to weigh evidence, but to determine whether there is a genuine issue for trial. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986). In determining whether there is a genuine issue of material fact, the Court must construe facts and inferences in a light most favorable to the nonmoving party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986).

Analysis

Section 523(a)(4) of the Bankruptcy Code excepts from discharge any debt “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” The creditor bears the burden of proving this exception to discharge by a preponderance of the evidence. *Estate of Cora v. Jahrling (In re Jahrling)*, 816 F.3d 921, 925 (7th Cir. 2016) (citing *Grogan v. Garner*, 498 U.S. 279 (1991)). There are three elements that a creditor must prove by a preponderance of the evidence in order to prove a § 523(a)(4) nondischargeability claim: (1) the existence of a trust; (2) that the debtor is a fiduciary of that trust; and (3) that the debtor committed “fraud or defalcation” while acting as a fiduciary of the trust. *Chase Lumber & Fuel Co. v. Koch (In re Koch)*, 197 B.R. 654, 656 (Bankr. W.D. Wis. 1996); *Harsch v. Eisenberg (In re Eisenberg)*, 189 B.R. 725, 730 (Bankr. E.D. Wis. 1995).

I. Crescent has met its burden of proving by a preponderance of the evidence that the sums paid by the owners on the projects constituted a trust fund.

Wisconsin’s theft-by-contractor statute establishes an express trust for sums paid by the owner to the contractors for the benefit of subcontractors and material suppliers. *Kraemer Bros., Inc. v. Pulaski State Bank*, 138 Wis. 2d 395, 399-400, 406 N.W.2d 379, 381 (1987). Section 779.02(5) states in relevant part:

[A]ll moneys paid to any prime contractor or subcontractor by any owner for improvements, constitute a trust fund only in the hands

of the prime contractor or subcontractor to the amount of all claims due or to become due or owing from the prime contractor or subcontractor for labor, services, materials, plans, and specifications used for the improvements, until all the claims have been paid, and shall not be a trust fund in the hands of any other person. The use of any such moneys by any prime contractor or subcontractor for any other purpose until all claims . . . have been paid in full or proportionally in cases of a deficiency, is theft by the prime contractor or subcontractor of moneys so misappropriated and is punishable under s. 943.20.

Wis. Stat. § 779.02(5) (emphasis added). “The statute makes a contractor a trustee of funds received from an owner until the laborers, material suppliers, or subcontractors are paid for work or materials put into the specific improvement for which the payment was made.” *Chase Lumber & Fuel Co.*, 197 B.R. at 656. To determine whether a trust exists, “the Court must determine whether (1) an owner (2) paid monies (3) to a prime or subcontractor (4) for improvements.” *Ganther Constr., Inc. v. Ward (In re Ward)*, 417 B.R. 582, 587 (Bankr. E.D. Wis. 2009).

The undisputed facts of this case show that Coates Electric received money from owners or general contractors for improvements. Sisian LLC, the owner of the SMB Watertown project, paid Coates Electric \$41,000. Affidavit of Jack Takerian, Docket No. 19, ¶ 4. Mr. Takerian attached to his Affidavit a copy of the \$41,000 check made out to Coates Electric. *Id.* ¶ 4, Ex. B. Jeffrey Fillinger, the owner of Mary’s Custom Storage, paid Coates Electric \$22,000. Affidavit of Jeffrey Fillinger, Docket No. 19, ¶ 4. Mr. Fillinger attached to his Affidavit a copy of the \$22,000 check made out to Coates Electric. *Id.* Christopher Herschleb, the managing member of the general contractor for the Pizza Ranch project, asserts in his affidavit that his company paid Coates Electric \$91,500; however, the copies of the checks made out to Coates Electric attached to his Affidavit only add up to \$82,350. Affidavit of Christopher Herschleb, Docket No. 19, ¶ 7. Mr. Coates has not contested these facts in his Affidavit; therefore, for the purposes

of this Motion, the Court has treated these facts as undisputed. *See* Fed. R. Civ. P. 56(e)(2), as incorporated by Fed. R. Bankr. P. 7056.

The undisputed facts of this case also show that Coates Electric did not pay the money received for the SBM Watertown project, the Mary's Custom Storage project, or the Pizza Ranch project to its supplier, Crescent. Crescent's District Credit Manager, Lisa Rusch, submitted an Affidavit showing that the value of electrical materials, fixtures, and other supplies furnished to Coates Electric for use and incorporation into the projects was \$48,557.34. Rusch Aff. ¶ 5. Ms. Rusch also attached invoices to her Affidavit detailing the value of the goods provided for the projects. *Id.* ¶ 14, Ex. D. She attached \$25,057.32 in invoices for the SBM Watertown project, \$6,267.55 in invoices for the Mary's Custom Storage project, and \$17,232.47 in invoices for the Pizza Ranch project. *Id.* She further noted that after the filing of a construction lien against the Pizza Ranch project, Crescent received a payment of \$15,000 directly from the owner, thereby reducing the amount due on the Pizza Ranch invoices to \$2,232.47. *Id.* ¶¶ 6, 12. The total remaining amount owed to Crescent from Coates Electric is \$33,557.34. *Id.* ¶ 7. Mr. Coates has not contested these facts in his Affidavit; therefore, for the purposes of this Motion, the Court has treated these facts as undisputed. *See* Fed. R. Civ. P. 56(e)(2), as incorporated by Fed. R. Bankr. P. 7056.

Crescent has met its burden of proving by a preponderance of the evidence that, under Wisconsin's theft-by-contractor statute, the sums paid to Coates Electric for the SBM Watertown project (\$41,000), the Mary's Custom Storage project (\$22,000), and the Pizza Ranch project (\$82,350) constituted a trust fund for the purpose of paying Coates Electric's suppliers, including Crescent.

II. Crescent has met its burden of proving by a preponderance of the evidence that Brody Coates was a fiduciary of the trust under 11 U.S.C. § 523(a)(4).

The second element of a § 523(a)(4) claim based upon Wisconsin's theft-by-contractor statute is that the debtor must be a fiduciary of a trust. Wisconsin's theft-by-contractor statute "creates an express fiduciary relationship" for the purposes of § 523(a)(4). *Chase Lumber & Fuel Co.*, 197 B.R. at 658; *see also Lenfant v. Hall (In re Hall)*, 581 B.R. 864, 867-68 (Bankr. W.D. Wis. 2018). As explained by the Wisconsin Supreme Court,

[A]s long as payments can be traced from the owner to the subcontractor the monies in the hands of the subcontractor are held in trust under the statute for the benefit of the second-tier subcontractors. This interpretation of the statute comports with the practices of the industry. Typically the prime contractor serves as a conduit for payments from an owner to a subcontractor. This interpretation also comports with the policy of the statute, which is to assist subcontractors and their subcontractors and suppliers in getting paid and to protect owners and prime contractors from paying twice.

Kraemer Bros., 138 Wis. 2d at 402-03. In other words, "if one can trace payments from the owner of the project to the subcontractor, and if there are 'second-tier' subcontractors or suppliers to be paid out of those payments, then the subcontractor is a 'fiduciary' within the meaning of the statute." *Ganther Constr., Inc.*, 417 B.R. at 589.

The undisputed facts of this case show that the Debtor was a fiduciary of the trust. The payments from the owners of the SBM Watertown project, the Mary's Custom Storage project, and the Pizza Ranch project can clearly be traced to Coates Electric. *Takerian Aff.* ¶ 6; *Fillinger Aff.* ¶ 6; *Herschleb Aff.* ¶ 8. Crescent, as Coates Electric's supplier, was supposed to be paid out of those payments for the materials that it supplied for these projects. *Rusch Aff.* ¶ 14. Coates Electric is therefore a fiduciary under Wisconsin's theft-by-contractor statute.

Brody Coates, as the sole owner of Coates Electric, is also a fiduciary of the trust under the express terms of the statute which provides, “[i]f the prime contractor or subcontractor is a ... limited liability company ... , such misappropriation also shall be deemed theft by any officers, directors, members, partners, or agents responsible for the misappropriation.” Wis. Stat. § 779.02(5). Such officers, directors, members, partners, or agents are personally liable for the theft, regardless of whether they personally benefited from the misappropriation. *Burmeister Woodwork Co., Inc. v. Friedel*, 65 Wis. 2d 293, 298 (1974). Crescent has met its burden of proving by a preponderance of the evidence that Brody Coates was a fiduciary under § 523(a)(4).

III. There remains an issue for trial as to the amount of damages to be awarded to Crescent Electric.

There appears to be a fact issue remaining for trial concerning whether the Debtor paid Crescent “proportionally.” The theft-by-contractor statute contains a proportionality requirement. *See State v. Keyes*, 2008 WI 54, ¶¶ 27-34, 309 Wis. 2d 516, 531-33, 750 N.W.2d 30, 37-39. As stated in Wis. Stat. § 779.02(5),

[t]he use of any such moneys by any prime contractor or subcontractor for any other purpose until all claims . . . have been paid in full or proportionally in cases of a deficiency, is theft by the prime contractor or subcontractor of moneys so misappropriated and is punishable under s. 943.20.

Wis. Stat. § 779.02(5). In other words, before using trust funds for purposes other than paying for labor, services, materials, plans, and specifications, subcontractors, like Coates Electric, are required by the theft-by-contractor statute to pay trust fund money proportionally to their suppliers in cases of deficiency. *See Keyes*, 2008 WI 54, at ¶ 34. The use of trust fund money by a subcontractor for any purpose until all claims have been paid in full or proportionally in cases of deficiency is theft by contractor. *See* Wis. Stat. § 779.02(5); *Keyes*, 2008 WI 54, ¶¶ 28, 34.

Based upon the affidavits that have been submitted there appears to be a factual dispute at this time as to whether Coates Electric was paid in full for the SBM Watertown project, the Mary's Custom Storage project, and the Pizza Ranch project. Each of the affiants for the projects avers that Coates Electric was paid in full for their respective project. Mr. Takerian states on behalf of the SBM Watertown project, "[t]he Owner paid Coates \$41,000 (Forty-One Thousand) for the Project, which was payment in full for the Project." Takerian Aff. ¶ 4. Mr. Herschleb states on behalf of the Pizza Ranch project, "[t]he Contractor paid Coates \$91,500.00 for the Project, which was payment in full for the Project." Herschleb Aff. ¶ 7. Mr. Fillinger states on behalf of the Mary's Custom Storage project, "I paid Coates \$22,000 for the Project, which was payment in full for the Project." Fillinger Aff. ¶ 4.

In his affidavit, Mr. Coates disputes that Coates Electric was paid in full on all three of these projects. Affidavit of Brody Coates, Docket No. 22-1. Mr. Coates asserts in his affidavit that Coates Electric is owed \$1,025.50 on the SBM Watertown project, \$12,345.00 on the Pizza Ranch project, and \$30,325.88 on the Mary's Custom Storage project. Coates Aff. ¶¶ 5-6, 8.

The evidence submitted by Mr. Coates in support of his statements regarding the SBM Watertown project and the Pizza Ranch project is weak to say the least. Mr. Coates states that he has attached an accounts receivable report to his affidavit which shows the amounts due to Coates Electric on the projects. There is no accounts receivable report attached to his affidavit. Instead, there is an accounts payable report attached to his affidavit and there is no reference to the SBM Watertown project or the Pizza Ranch project on that accounts payable report. *Id.*, Ex. 1. The Court is really only left with Mr. Coates' statements made under oath in his affidavit that Coates Electric is owed \$1,025.50 on the SBM Watertown project and \$12,345.00 on the Pizza Ranch project.

The evidence submitted by Mr. Coates in support of his statements regarding the Mary's Custom Storage project is slightly better. Mr. Coates has attached to his affidavit an invoice from Coates Electric to Mary's Custom Storage for \$30,235.88 dated December 14, 2018. *Id.* ¶ 7, Ex. 2. It is not clear to the Court why this invoice is dated eight months after Mary's Custom Storage believed it had made payment in full on the project in April 2018. *Fillinger Aff.* ¶ 6.

Construing the facts and making inferences in a light most favorable to Mr. Coates, there appears to be a question of fact as to whether Coates Electric was paid in full on all three projects. If Coates Electric only received partial payment on the three projects, then there is a proportionality issue as to the amount of damages to be paid to Crescent on its theft-by-contractor claim. This precludes the entry of summary judgment in Crescent's favor.

IV. There remains an issue for trial as to Mr. Coates' state of mind while acting in a fiduciary capacity.

The third and final element necessary to make a theft-by-contractor claim under Wisconsin law nondischargeable pursuant to § 523(a)(4) is that the defendant committed "fraud or defalcation while acting in a fiduciary capacity." In the context of § 523(a)(4), fraud and defalcation means "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Bullock v. BankChampaign, N.A.*, 569 U.S. 267, 273 (2013) (quotation omitted). The Supreme Court included "as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as the equivalent. Thus, we include reckless conduct of the kind set forth in the Model Penal Code." *Id.* at 273-74. Defalcation "requires proof of 'a culpable state of mind . . . involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior.'"

Jahrling, 816 F.3d at 925 (quoting *Bullock*, 569 U.S. at 269). “Defalcation” as used in § 523(a)(4) need not involve bad faith, but its “state-of-mind requirement requires at least a subjective, criminal level of recklessness.” *Id.*; see also *Bullock*, 569 U.S. at 274. Following the Model Penal Code definition, an “intentional wrong” includes conduct that takes place when a fiduciary “‘consciously disregards’ (or is willfully blind to) ‘a substantial and unjustifiable risk’ that his conduct will turn out to violate a fiduciary duty. . . . That risk ‘must be of such a nature and degree that, considering the nature and purpose of the actor’s conduct and the circumstances known to him, its disregard involves a *gross deviation* from the standard of conduct that a law-abiding person would observe in the actor’s situation.’” *Bullock*, 569 at 275 (quoting Model Penal Code § 2.02(2)(c), p. 226 (1985)).

After the Supreme Court’s decision in *Bullock*, a finding that a debtor has violated Wisconsin’s theft-by-contractor statute does not per se lead to a determination that a debt is nondischargeable under § 523(a)(4). See *K&D Masonry LLC v. Vieaux (In re Vieaux)*, Ch. 13 Case No. 12-36663, Adv. No. 13-2196, 2013 WL 5935156, at *2-3 (Bankr. E.D. Wis. Nov. 5, 2013). Rather, even if a debtor has violated the statute, the Court “must make a finding regarding the debtor’s state of mind while acting in a fiduciary capacity.” *Id.* at *3. Often, this type of claim is ill-suited for summary judgment. *Id.*

The “state of mind” analysis involved in determining whether Mr. Coates committed “fraud or defalcation while acting in a fiduciary capacity” precludes the entry of summary judgment in favor of Crescent. There are simply not enough undisputed facts in the record from which the Court can discern Mr. Coates’ state of mind.

Mr. Coates asserts that he “relied on the financial records available to him to make payment to creditors of Coates Electric” and “[a]s the business wound down in October 2018,

Mr. Coates had reason to believe that its customers had not paid all amounts due to Coates Electric, LLC.” Defendant’s Brief, Docket No. 22 at 5. “Thus, Mr. Coates relied on that information to distribute the remaining funds available to the best of his ability and in good faith.” *Id.* He further asserts that he has “been unable to access Coates Electric, LLC’s financial records that were maintained through Foundations Software. To the extent that accounting errors occurred, it was the result of inadvertent error and not intentional.” Coates Aff. ¶ 13.

Crescent counters that the failure of Mr. Coates and Coates Electric to pay Crescent, which resulted in the filing of liens on the properties associated with the projects, constitutes a conscious disregard of his fiduciary duty as the owner of Coates Electric. According to Crescent, his attempts to deflect responsibility for his actions and Coates Electric’s actions by claiming that he is unable to access Coates Electric’s financial information and that any accounting errors were inadvertent and unintentional just shows his willful blindness and conscious disregard of the substantial and unjustifiable risk that his conduct was violating his fiduciary duty.

To decide whether Mr. Coates committed fraud or defalcation in a fiduciary capacity, the Court must make a finding regarding his state of mind while acting in a fiduciary capacity. This type of determination is ill-suited for summary judgment. Without hearing from Mr. Coates, and assessing his credibility on the witness stand, the Court cannot say one way or the other based upon the parties’ written submissions whether Mr. Coates acted negligently (which is insufficient to show defalcation within the meaning of § 523(a)(4)) or whether Mr. Coates acted with gross, criminal recklessness such that he consciously disregarded or was willfully blind to a substantial and unjustifiable risk that his conduct would turn out to violate a fiduciary duty (which is sufficient to show defalcation within the meaning of § 523(a)(4)). Consequently, there remains

an issue of fact for trial as to Mr. Coates' state of mind while acting in a fiduciary capacity. This precludes the entry of summary judgment in favor of Crescent.

V. There remains an issue for trial as to whether Crescent is entitled to treble damages under Wisconsin's theft-by-contractor statute.

Crescent has also asserted that it is entitled to treble damages pursuant to Wis. Stat.

§ 895.446(1) and (3). Section 895.446(1) states:

[a]ny person who suffers damage or loss by reason of intentional conduct ... that is prohibited under ... s. 943.20 ... has a cause of action against the person who caused the damage or loss.

Sections 895.446(3)(a) and (c) state:

If the plaintiff prevails in a civil action under sub. (1), he or she may recover all of the following: (a) Actual damages ... (c) Exemplary damages of not more than 3 times the amount awarded under par. (a). No additional proof is required under this section for an award of exemplary damages under this paragraph.

The treble damages remedy of Wis. Stat. § 895.446 is available in civil theft-by-contractor cases. *Tri-Tech Corp. of Am. v. Americomp Servs., Inc.*, 2002 WI 88, ¶ 24, 254 Wis. 2d 418. To obtain an award of treble damages, the party seeking treble damages must prove, by a preponderance of the evidence, the elements of a theft-by-contractor claim under Wis. Stat. § 779.02(5) and criminal intent to defraud under § 943.20. *Id.* at ¶ 24. “The issue of intent is generally not readily susceptible of determination on summary judgment.” *Id.* at ¶ 30 n.5 (citations omitted) (“We have stated . . . the issue of . . . intent is not one that properly can be decided on a motion for summary judgment. Credibility of a person with respect to his subjective intent does not lend itself to be determined by affidavit.”).

There remains an issue of fact for trial as to whether Mr. Coates acted with a “criminal intent to defraud” to permit the Court to award treble damages to Crescent. The issue of intent is ill-suited for summary judgment because the credibility of a person with respect to his subjective

intent does not lend itself to be determined on affidavit. This precludes the Court from entering summary judgment in favor of Crescent on its claim for treble damages.

Conclusion

Because there are genuine issues of material fact as to the amount of the debt owed to Crescent, whether Mr. Coates committed fraud or defalcation pursuant to § 523(a)(4), and whether Mr. Coates is liable for treble damages under Wisconsin law, the Court must deny the Motion for Summary Judgment. Accordingly,

IT IS THEREFORE ORDERED: the Motion for Summary Judgment filed by Crescent Electric Supply Company is denied.

IT IS FURTHER ORDERED: the Court will hold a status conference by telephone on **April 20, 2021, at 12:00 p.m.** to schedule the matter for further proceedings.

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