

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF WISCONSIN

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In re

HARRY H. PEGELOW and  
BERNICE G. PEGELOW,

Debtors.

Case No. 99-25383

Chapter 7

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SCOTT MASON and  
KERRY L. MASON,

Plaintiffs,

v.

Adversary No. 99-2407

HARRY H. PEGELOW and  
BERNICE G. PEGELOW,

Defendants.

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MEMORANDUM DECISION ON DEFENDANTS' MOTION TO DISMISS

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The plaintiffs filed this adversary proceeding against the debtors, asking that a debt be excepted from the debtors' discharge under 11 U.S.C. § 523(a)(4). The complaint alleges that the debtors, doing business as H & H Construction, used monies paid to them for purposes other than paying the material supplier, in violation of Wisconsin's theft by contractor statute, § 779.02(5), Wis. Stats. The debtors filed a motion to dismiss on the grounds that the plaintiffs have failed to state a claim upon which relief may be granted. The parties both filed briefs and the court took the matter under advisement.

This court has jurisdiction under 28 U.S.C. § 1334(b), and this is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following opinion constitutes the court's findings of fact and

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conclusions of law pursuant to Fed. R. Bankr. P. 7052.

### BACKGROUND

All of the material facts are undisputed. The Masons contracted with the Pegelows for the construction of a concrete driveway at the Masons' home. Mr. Pegelow completed the work on the contract in June 1996 and was paid a total of \$8,375. The concrete used for the driveway was obtained from Manthey Ready Mix and cost approximately \$2,379. Shortly after installation of the Masons' driveway, the concrete started peeling and crumbling. The same defect occurred on other concrete jobs performed by Mr. Pegelow and supplied by Manthey.

Although the Masons paid the Pegelows for the cost of the concrete, the latter admits that they did not pay Manthey due to the defective concrete which was provided for this and several other jobs. To this date, Manthey has neither brought an action against the debtors to recover its payments for supplying the concrete, nor has it filed a lien against the Masons' property or attempted to collect from the Masons in any way.

### ARGUMENTS

The debtors argue that the plaintiffs have no cause of action against them as there was no lien filed by Manthey on the plaintiffs' home. Under Wisconsin construction lien law, notice of a lien must be given to the owners, within six months of that time the lien claimant must file a claim for the lien, and an action must be brought within two years of the filing of the lien claim. *See* Wis. Stat. § 779.02, .06. The debtors assert that since this was not done, the plaintiffs cannot be liable to Manthey because of its failure to follow statutory construction lien procedure. Thus, the plaintiffs have no damages resulting from the debtors' failure to pay Manthey. The debtors further argue that the plaintiffs have no right to sue on behalf of Manthey. According to the

debtors, the plaintiffs might have more appropriately brought an action against Manthey for the defective concrete, even though the Masons contracted with the debtors and not with Manthey.

The plaintiffs point out that, although the debtors were required to hold the money paid in trust pursuant to section 779.02(5), Wis. Stats., the Pegelows did not use that money on the construction of the Masons' driveway, and they did not pay the material supplier. The plaintiffs argue that since the money held by the debtors was trust funds, it should have been returned to them if it was not paid to Manthey.

#### DISCUSSION

A motion to dismiss challenges the sufficiency of the complaint for failure to state a claim upon which relief may be granted. *See* Fed. R. Civ. P. 12(b)(6) (made applicable to adversary proceedings by Fed. R. Bankr. P. 7012). The court will review all facts alleged in the complaint and any inferences reasonably drawn therefrom in the light most favorable to the plaintiffs. *See Marshall-Mosby v. Corporate Receivables, Inc.*, 205 F.3d 323, 326 (7<sup>th</sup> Cir. 2000). Dismissal will only be warranted if the plaintiffs can prove no set of facts in support of their claims that would entitle them to relief. *See Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99 (1957).

Section 523(a)(4) of the Bankruptcy Code provides that a debtor does not receive a discharge of any debt incurred by way of "defalcation while acting in a fiduciary capacity." State law determines whether a fiduciary relationship exists. *See, e.g., Matter of Thomas*, 729 F.2d 502 (7<sup>th</sup> Cir. 1984). Section 779.02(5), Wis. Stats., creates a trust fund in the hands of a prime contractor or subcontractor for funds received from an owner for payment of improvements. The statute provides in pertinent part as follows:

[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 and materials 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, except those which are the subject of a bona fide dispute and then only to the extent of the amount actually in dispute, 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.

Section 779.02(5), Wis. Stats. The statute results in a corresponding civil action for parties damaged by its violation. *See, e.g., Thomas, 729 F.2d 502; Capen Wholesale, Inc. v. Probst, 180 Wis. 2d 354, 509 N.W.2d 120 (Ct. App. 1993).* Even if, for purposes of this decision, the court assumes that the debtors used the money for their own purposes, these plaintiffs nevertheless do not have a right to recover under the statute.

A trust requires a fiduciary, *see Loehrke v. Wanta Builders, Inc., 151 Wis. 2d 695, 702-03, 445 N.W.2d 717, 720 (Ct. App. 1989)*, which may include the owners of the property upon which work was performed. *See Thomas, 729 F.2d at 506.* It protects owners by ensuring that the suppliers are paid so they do not file liens on the owner's property. *See Wisconsin Dairies Cooperative v. Citizens Bank & Trust, 160 Wis. 2d 758, 770, 467 N.W.2d 124, 129 (1991)* (noting that the statutory trust provision is a remedy against contractors, and the statutory lien provisions provide subcontractors a remedy against owners). The statute does not make the debtor a trustee for the owners. When the threat of a lien filing expires, as it has here, this statutory protection is no longer necessary as to the owners, making Manthey the only possible beneficiary of the trust. As there is no contract between the Masons and Manthey, the plaintiffs

have no right to sue on Manthey's behalf.<sup>1</sup>

Finally, whether or not the Pegelows breached their fiduciary duty to Manthey is not and, due to the bar date for objections to dischargability of debts having past, will never be before this court. The plaintiffs may have a claim for a defective product against the Pegelows. Unfortunately for the plaintiffs, however, such a claim is dischargeable in bankruptcy.

For the reasons set forth above, the debtors' motion to dismiss is granted. A separate order consistent with this decision will be entered.

Dated at Milwaukee, Wisconsin, December 15, 2000.

~~BY THE COURT~~



Honorable Margaret Dee McGarity  
United States Bankruptcy Judge

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<sup>1</sup> If they did, the debtor might have defenses relating to the defective product. *Loehrke*, 151 Wis. 2d at 704 (holding that if the prime contractor has good cause to refuse to pay, it has not violated its fiduciary duty). However, the plaintiffs are not attempting to stand in Manthey's shoes in this action.