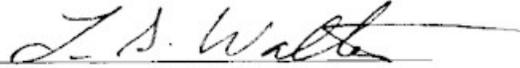


This document has been electronically entered in the records of the United States Bankruptcy Court for the Southern District of Ohio.

IT IS SO ORDERED.

Dated: September 30, 2008


Lawrence S. Walter
United States Bankruptcy Judge

**UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION AT DAYTON**

In re: KENNETH L. SCHRIBER,
Debtor

Case No. 07-33547
Adv. No. 07-3295

KILGUST MECHANICAL, INC.,
Plaintiff

Judge L. S. Walter
Chapter 7

v.

KENNETH L. SCHRIBER,
Defendant

**DECISION OF THE COURT GRANTING SUMMARY JUDGMENT TO
PLAINTIFF KILGUST MECHANICAL, INC.**

The court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a) and 1334, and the standing General Order of Reference in this District. This matter is before

the court on the motion for summary judgment filed by Plaintiff Kilgust Mechanical, Inc. (“Kilgust”) [Adv. Doc. 17], the response filed by Defendant-Debtor Kenneth L. Schriber (“Debtor”) [Adv. Doc. 18] and the reply filed by Kilgust [Adv. Doc. 21].

The matter to be determined on summary judgment is whether this court should give preclusive effect to a state court judgment taken by Kilgust against the Debtor and except the underlying debt from the Debtor’s discharge pursuant to 11 U.S.C. § 523(a)(4). For the reasons that follow, the court concludes that: 1) the state court judgment is entitled to preclusive effect; and 2) the judgment’s findings, along with the Debtor’s admissions in his answer, establish the elements for “defalcation while acting in a fiduciary capacity” pursuant to § 523(a)(4). Consequently, the debt is determined to be nondischargeable.

FACTUAL AND PROCEDURAL BACKGROUND

The following facts are relevant to determining the issues on summary judgment and are not in dispute.¹ In 2002, Energizer Heat Exchangers Division (“Energizer”), a division of the Schriber Company, entered into a contract with Frito-Lay on a project to improve a commercial property in Beloit, Wisconsin [Adv. Doc. 1 (“Compl.”) ¶¶ 8-9; Adv. Doc. 5 (“Ans.”)² ¶ 1]. The Debtor is the sole officer, director and shareholder of the Schriber Company and its divisions [Compl. ¶ 13 and Ex. B (“Summary Judgment Decision”) p. 6; Ans. ¶¶ 1, 5].

¹ In his response on summary judgment, the Debtor notes that the facts in this case are not in dispute [Adv. Doc. 18].

² The Debtor amended his answer to add supplemental defenses, but the factual admissions are found in the original answer [*compare* Adv. Doc. 5 and Adv. Doc. 8].

In October of 2002, Energizer entered into a subcontract agreement with Kilgust for Kilgust to provide labor and material for the project [Compl. ¶ 10; Ans. ¶ 1]. Under the terms of the contract, Kilgust was to be paid \$66,250.00 [Compl. ¶ 10; Ans. ¶ 1].

Frito-Lay paid Energizer in full for the project including the labor and materials provided by Kilgust [Compl. ¶ 11; Ans. ¶ 1]. However, Energizer only paid \$10,000 to Kilgust leaving a balance of \$56,250.00 owed to Kilgust under the terms of the contract [Compl. ¶ 11; Ans. ¶ 1].

In September of 2003, Kilgust filed a Complaint against Energizer, the Schriber Company and the Debtor in the Circuit Court of Rock County, Wisconsin [Compl. ¶ 12; Ans. ¶ 2]. In October of 2004, the Wisconsin court awarded summary judgment in favor of Kilgust on its claims for breach of contract against Energizer and civil “theft by contractor” pursuant to Wis. Stat. § 779.02(5) against Energizer, Schriber Company and the Debtor [Compl. ¶ 13; Ans. ¶¶ 1, 5]. In its decision, the Wisconsin court considered the Debtor’s argument that the funds were not stolen or misappropriated but were levied upon by the Internal Revenue Service, a fact to which the Debtor also attests in response to Kilgust’s motion for summary judgment in this court [Summary Judgment Decision p. 14; Aff. of Debtor attached to Doc. 18]. While the Wisconsin court found the Debtor’s argument relevant to Kilgust’s claim of intentional misappropriation / criminal theft by contractor, the court specifically noted that the Debtor’s lack of wrongful intent was not relevant to establish civil theft by contractor [Summary Judgment Decision pp. 9-14]. The Wisconsin court held that the Debtor, as sole shareholder of Schriber Company and Energizer, had the duty and admitted responsibility to ensure that the money received by Energizer on the Project was held and used in accordance with the trust fund statute

[Summary Judgment Decision p. 9]. Because the entrusted funds were not paid to Kilgust in accordance with the statute, the Debtor was responsible for their misappropriation under the civil “theft by contractor” statute, Wis. Stat. § 779.02(5) [*Id.*].

The Wisconsin court awarded judgment against Energizer, Schriber Company and the Debtor, jointly and severally, on the civil “theft by contractor” claim [Compl. ¶ 13 and Exs. C and D; Ans. ¶¶ 1, 5]. The total amount of the judgment, with prejudgment interest and costs, was \$62,867.51 plus post-judgment interest [Compl. ¶ 13 and Ex. D; Ans. ¶¶ 1, 5]. In March of 2005, the judgment was amended by stipulation and increased to \$67,867.51 plus post-judgment interest [Compl. ¶ 13 and Ex. E; Ans. ¶¶ 1, 5].

SUMMARY JUDGMENT STANDARD

The appropriate standard to address Kilgust’s motion for summary judgment filed in this adversary proceeding is contained in Fed. R. Civ. P. 56(c) and incorporated in bankruptcy adversary proceedings by reference in Fed. R. Bankr. P. 7056. Rule 56(c) states in part that a court must grant summary judgment to the moving party if:

the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. P. 56(c). In order to prevail, the moving party, if bearing the burden of persuasion at trial, must establish all elements of its claim. *Celotex Corp. v. Catrett*, 477 U.S. 317, 331 (1986). If the burden is on the nonmoving party at trial, the movant must: 1) submit affirmative evidence that negates an essential element of the nonmoving party’s claim; or 2) demonstrate to the court that the nonmoving party’s evidence is insufficient to establish an essential element of the nonmoving party’s claim. *Id.* at 331-32.

Thereafter, the opposing party “must come forward with ‘specific facts showing that there is a genuine issue for trial.’” *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986) (citations omitted); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-251 (1986). All inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. *Matsushita*, 475 U.S. at 586-88.

LEGAL ANALYSIS

Kilgust asserts that the debt owed to it by the Debtor as determined in the Wisconsin court’s decision and judgment (“Wisconsin judgment”) should be found nondischargeable pursuant to 11 U.S.C. § 523(a)(4). More specifically, Kilgust asserts that the debt is excepted from discharge because it constitutes a debt for “defalcation while acting in a fiduciary capacity[.]” 11 U.S.C. § 523(a)(4).

In the Sixth Circuit, a “defalcation” for §523(a)(4) nondischargeability purposes has been found to encompass “not only embezzlement and misappropriation by a fiduciary, but also the ‘failure to properly account for such funds.’” *Board of Trustees of the Ohio Carpenters’ Pension Fund v. Bucci (In re Bucci)*, 493 F.3d 635, 639 (6th Cir. 2007) (further citation omitted). “A debt is nondischargeable as a defalcation when the preponderance of the evidence establishes: ‘(1) a preexisting fiduciary relationship; (2) breach of that fiduciary relationship; and (3) a resulting loss.’” *Id.* (citing *Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 390 (6th Cir. 2005)).

The Sixth Circuit has also taken the opportunity to consider the nature of the “fiduciary capacity” requirement found in the defalcation provision of § 523(a)(4) and construes the term narrowly. *See Bucci*, 493 F.3d at 639; *Blaszak*, 397 F.3d at 391. To

satisfy the fiduciary relationship requirement in the context of a defalcation, the debtor must hold funds in a trust for a third party. *Blaszak*, 397 F.3d at 391. The fiduciary relationship must turn on the existence of a pre-existing express or technical trust whose res encompasses the property at issue. *Id.* The provision does not extend to constructive or implied trusts imposed as an equitable remedy. *Id.*; *Bucci*, 493 F.3d at 639-40. Nonetheless, a statute may create the trust if the statute defines the trust res, imposes duties to a beneficiary on the trustee, and those duties exist prior to any wrongdoing. *Bucci*, 493 F.3d at 640.

Kilgust argues that the requirements for nondischargeability pursuant to § 523(a)(4) are met with the Wisconsin judgment. Kilgust asserts that the judgment conclusively establishes: 1) that a fiduciary relationship existed between Kilgust and the Debtor; 2) that the Debtor breached his fiduciary duty by failing to pay Kilgust the funds that had been entrusted to the Debtor by Frito-Lay; and 3) that the breach caused a resulting loss in the amount of the judgment. Furthermore, Kilgust asserts that the Wisconsin judgment and that court's specific finding that the Wisconsin "theft by contractor" statute was applicable to the Debtor satisfies the Sixth Circuit's requirement that there be a pre-existing trust.

Before this court may determine whether the findings in the Wisconsin judgment meet the requirements of § 523(a)(4), the court must make the preliminary determination of whether that state court judgment is entitled to preclusive effect. Pursuant to 28 U.S.C. § 1738, federal courts are directed to give the same "full faith and credit" to a state court judgment as would be given that judgment under the law of the state in which the judgment is rendered. *Bay Area Factors v. Calvert (In re Calvert)*, 105 F.3d 315, 317

(6th Cir. 1997). Consequently, in order for the Wisconsin judgment to have preclusive effect in a bankruptcy court, it must have preclusive effect in Wisconsin state courts under estoppel principles. *Id. See also In re Jaynes*, 377 B.R. 880, 883-84 (Bankr. W.D. Wis. 2007).

In Wisconsin courts, collateral estoppel or issue preclusion as it is also known, is a doctrine designed to limit relitigation of issues that were contested in a previous action between the same or different parties. *Blaha v. Schoff (In re Schoff)*, 2005 WL 3201141, at *3 (W.D. Wis. Nov. 28, 2005). “Accordingly, when an issue is actually litigated and determined by a valid final judgment and the determination is essential to the judgment it is conclusive in a subsequent action whether on the same or a different claim.” *Id. See also Jaynes*, 377 B.R. at 884. However, “where appropriate, a fundamental fairness analysis should be conducted when determining whether it is equitable to apply issue preclusion in a given case.” *Schoff*, 2005 WL 3201141, at *3.

The court begins by noting that Wisconsin courts treat a decision granting summary judgment as a conclusive and final judgment. *See Estate of Rille v. Physicians Ins. Co.*, 728 N.W.2d 693, 704 (Wis. 2007). Furthermore, Wisconsin courts follow the Restatement (Second) of Judgments which states that issues submitted on summary judgment are actually litigated for purposes of issue preclusion. *Estate of Rille*, 728 N.W.2d at 704 n.24 (citing Restatement (Second) of Judgments § 27, comment d (1982)). Finally, it is clear that the facts and conclusions relied upon by Kilgust to establish defalcation under § 523(a)(4) are the same facts essential to the Wisconsin court’s conclusion that the Debtor was liable to Kilgust under the Wisconsin civil “theft by

contractor” statute, Wis. Stat. § 779.02(5), in the amount of \$67,867.51 plus post-judgment interest.³

The court must next determine whether applying issue preclusion comports with principles of fundamental fairness. While this is generally a discretionary decision, courts are to consider a number of non-exclusive factors including:

(1) could the party against whom preclusion is sought, as a matter of law, have obtained review of the judgment; (2) is the question one of law that involves two distinct claims or intervening contextual shifts in the law; (3) do significant differences in the quality or extensiveness of proceedings between the two courts warrant relitigation of the issue; (4) have the burdens of persuasion shifted such that the party seeking preclusion had a lower burden of persuasion in the first trial than in the second; or (5) are matters of public policy and individual circumstances involved that would render the application of collateral estoppel to be fundamentally unfair, including inadequate opportunity or incentive to obtain a full and fair adjudication in the initial action?

Jaynes, 377 B.R. at 887 (citing *Michelle T. v. Crozier*, 495 N.W.2d 327 (1993)).

The Debtor does not question that he had a full opportunity to litigate the issues in the state court, that he was provided due process, and that the Wisconsin judgment is fundamentally fair. Furthermore, the Debtor has not argued that he lacked access to review of the Wisconsin judgment by a higher state court. Instead, the Debtor raises only two issues with regard to the state court judgment: 1) the Debtor questions the applicability of the Wisconsin “theft by contractor” statute given that the work completed by the Debtor’s company was conducted in Ohio; and 2) the Debtor asserts that he did

³ The factual and legal conclusions essential to the Wisconsin court’s decision on summary judgment and relevant to this matter include that: 1) Kilgust was retained as a subcontractor by the Debtor’s company; 2) The amount of the subcontract was \$66,250.00; 3) Frito-Lay paid the Debtor’s company in full for the project including the funds to be paid to Kilgust; 4) the Debtor’s company paid Kilgust only \$10,000 leaving a balance of \$56,250.00 owed under the subcontract; 5) that the Debtor individually had the duty and admitted responsibility to ensure that the money the Debtor’s company received was held and used in accordance with the trust fund statute; 5) the Debtor was personally responsible, jointly and severally with other defendants, for the misappropriation of the trust funds under the Wisconsin “theft by contractor” statute, Wis. Stat. § 779.02(5); 6) the amount owed to Kilgust as established by the amended judgment is \$67,867.51 plus interest.

not “misappropriate” the funds held in trust for Kilgust because the funds were levied upon by the IRS without the Debtor’s consent.

The issues raised by the Debtor go to the substance or “correctness” of the Wisconsin court’s decision rather than the fundamental fairness of the decision. Under both the Full Faith and Credit statute and the *Rooker-Feldman* doctrine, it is not appropriate for this court, as a lower federal court, to review the substance of the Wisconsin judgment during this dischargeability proceeding. *Sill v. Sweeney (In re Sweeney)*, 276 B.R. 186, 195 (6th Cir. B.A.P. 2002) (noting that only the Supreme Court can conduct such a review). Consequently, it is not appropriate for this court to review and re-determine the merits of the state court findings or the debt itself. *Id.* As noted before, the Debtor does not deny that he had a full and fair opportunity to litigate the relevant issues in state court, including the issues he now raises in bankruptcy court: the location of the work conducted by the Debtor’s company and the IRS levy. For these reasons, the court concludes that it is fundamentally fair and appropriate to apply the principles of issue preclusion with respect to the Wisconsin judgment in this bankruptcy dischargeability matter.

Next, the court returns to the elements of § 523(a)(4) to determine whether the Wisconsin judgment, along with the Debtor’s admissions in his answer, establish a nondischargeable debt for “defalcation while acting in a fiduciary capacity.”

As noted before, the first required element is that the Debtor and Kilgust have a fiduciary relationship that turns on the existence of a pre-existing express trust. *Bucci*, 493 F.3d at 639-40. Significantly, the Sixth Circuit has determined that a state statute establishing the duty of a contractor to hold funds in trust for the benefit of laborers and

subcontractors establishes the type of fiduciary relationship and express trust contemplated by § 523(a)(4)'s defalcation provision. *See Bucci*, 493 F.3d at 640 (discussing Michigan's Building Contract Fund Act); *Kriegish v. Lipan (In re Kriegish)*, 97 Fed. Appx. 4, 2004 WL 346041, at *5-6 (6th Cir. Feb. 23, 2004); *Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249, 252 (6th Cir. 1982). Moreover, an identical determination was reached by a Wisconsin bankruptcy court with respect to the Wisconsin "theft by contractor" statute, Wis. Stat. § 779.02(5), at issue in this case. *See Romes Design v. Dinkins (In re Dinkins)*, 327 B.R. 918, 922-23 (Bankr. E.D. Wis. 2005) (concluding that Wis. Stat. § 779.02(5) and its creation of a trust fund for sums paid by an owner to a general contractor for the benefit of subcontractors and material suppliers satisfied the requirement for a fiduciary relationship and express trust pursuant to 11 U.S.C § 523(a)(4)).

In this case, the Wisconsin judgment includes a determination that the Debtor, as the contractor, had the duty to hold the funds it received from Frito-Lay in trust for subcontractor Kilgust pursuant to the Wisconsin "theft by contractor" statute, Wis. Stat. § 779.02(5). Consequently, the judgment satisfies both the fiduciary relationship and pre-existing express trust requirements of § 523(a)(4).

The Wisconsin judgment further establishes that the Debtor breached its fiduciary duty when the trust funds were used for purposes other than payment to Kilgust. The Debtor attempts to combat this element by arguing that he did not purposefully misappropriate the funds; instead, the breach was unintentional and involuntarily caused by the IRS's levy of the funds without the Debtor's consent.⁴ However, as previously

⁴ To support that his lack of intent should preclude a determination of nondischargeability pursuant to § 523(a)(4), the Debtor cites *Smith Mountain Building Supply, LLC v. Shreve (In re Shreve)*, 386 B.R. 602

stated, the Sixth Circuit’s interpretation of “defalcation” includes “not only embezzlement and misappropriation by a fiduciary, but also the ‘failure to properly account for such funds.’” *Bucci*, 493 F.3d at 639. Consequently, even a debt caused by an innocent breach of fiduciary duty, where the debtor had neither personal gain nor subjective intent, can amount to a defalcation. *Hash v. Reed (In re Reed)*, 155 B.R. 169, 172 (Bankr. S.D. Ohio 1993) (noting that § 523(a)(4) is concerned with the act of failing to properly deal with entrusted property rather than “bad” conduct); *Highland v. Hix (In re Hix)*, 161 B.R. 401, 405 (Bankr. N.D. Ohio 1993) (determining that defalcation does not requiring a showing of intentional wrongdoing and may result from negligence or ignorance); *Ohio Casualty Ins. Co. v. Kern (In re Kern)*, 98 B.R. 321, 323-24 (Bankr. S.D. Ohio 1989). Consequently, the circumstance that entrusted funds were used for purposes other than payment to Kilgust and the Debtor cannot account for them establishes this element of § 523(a)(4) regardless of the fact that the Debtor’s breach was neither intentional nor voluntary.

The final element which Kilgust must demonstrate to establish nondischargeability is a resulting loss. Kilgust satisfies this element by reference to the Wisconsin judgment, as amended, which calculates Kilgust’s loss caused by the Debtor’s failure to pay over entrusted funds as \$67,867.51 plus post-judgment interest.

(Bankr. W.D. Va. 2008). While the facts of that case are somewhat similar, the Virginia bankruptcy court focused solely on whether those facts established larceny under § 523(a)(4) and not defalcation while acting in a fiduciary capacity. In the Sixth Circuit, the defalcation provision of § 523(a)(4) has been defined more broadly than either embezzlement or larceny to encompass not only misappropriation but also the failure to properly account for funds. See *Bucci*, 493 F.3d at 639. Consequently, the *Shreve* court’s determinations with respect to larceny are inapplicable to the case at hand.

CONCLUSION

Accordingly, the court determines that the debt owed by the Debtor to Kilgust pursuant to the Wisconsin judgment is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4).

SO ORDERED.

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