Wissen v. Aguado Stone, Inc.

United States District Court for the Western District of Texas, Austin Division

March 11, 2008, Decided; March 11, 2008, Filed

CAUSE NO. A-07-CA-506-LY

Reporter
2008 U.S. Dist. LEXIS 124253 *

KEVIN E. WISSEN, APPELLANT, v. AGUADO STONE, INC., APPELLEE.

Prior History: Aguado Stone, Inc. v. Wissen (In re Wissen), 2007 Bankr. LEXIS 5095 (Bankr. W.D. Tex., Mar. 27, 2007)

Core Terms

stone, trust fund, defalcation, fiduciary duty, final judgment, misapply, fiduciary capacity, nondischargeable, fiduciary, supplier

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For Aguado Stone, Inc., Appellee: N. West Short, LEAD ATTORNEY, West Short & Associates, P.C., Georgetown, TX.

Judges: LEE YEAKEL, UNITED STATES DISTRICT JUDGE.

Opinion by: LEE YEAKEL

Opinion

MEMORANDUM OPINION AND ORDER

Before the Court in the above styled and numbered cause of action is the appeal of Kevin Wissen from the Bankruptcy Court's judgment in favor of Appellee Aguado Stone, Inc., which ruled that the final judgment obtained by Aguado Stone against Wissen, individually and d/b/a Central Texas Masonry, in Cause No. 05-359-C26, 26th Judicial District Court of Williamson County, Texas (the "Debt") is a nondischargeable debt. *See 11 U.S.C. § 523(a)(4)*; Aguado Stone, Inc. v. Wissen, Adversary No. 06-1032-FM, 2007 Bankr. LEXIS 5095, Final Judgment On Complaint To Determine Dischargeability (Bankr. W.D. Tex. March 27, 2007). Specifically, Wissen contends that the Bankruptcy Court erred in determining the Debt is nondischargeable because Aguado Stone failed to establish that Wissen committed fraud or defalcation while acting in a fiduciary capacity that arose under the Texas Construction Trust Fund Statute. [1] **[*2]** Wissen requests that this Court reverse and render judgment that the Debt is dischargeable.

The parties filed briefs (Clerk's Document Nos. 3 and 4) and on September 28, 2007, the Court heard oral argument at which each party was represented by counsel. Having reviewed the parties' briefing and arguments, the record before the Bankruptcy Court, and the applicable law this Court will overrule Wissen's issues and affirm the Bankruptcy Court's judgment.

Stipulated facts

During the adversary proceeding, the parties stipulated to particular facts (Clerk's Document No. 1). *See* Appellant's Designation of The Issues and Items To Be Included In The Record On Appeal, Appellant Record Item No. 2. [2] Included here is a brief recitation of the relevant agreed facts.

During 2003 and 2004, Wissen, a construction contractor, ordered stone from Aguado Stone for use in Wissen's construction projects. Wissen received construction payments on each project, but failed to pay Aguado Stone in full for the stone. On several occasions, Wissen promised Aguado Stone **[*3]** that he would pay his outstanding invoices, and Aguado Stone, relying on those promises, continued to supply product

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[1] *See* Tex. Prop. Code Ann. §§ 162.001-.033 (West 2007).

[2] The parties submitted agreed stipulations of fact to the Bankruptcy Court on January 18, 2007.

to Wissen. On one occasion, Aguado Stone accepted a Jeep Wrangler from Wissen and, in return, credited Wissen's account with $25,000. Finally, despite numerous promises and Wissen's continued failure to pay, Aguado Stone commenced a civil action in state district court seeking the balance of Wissen's outstanding invoices. *See* Tex. Prop. Code Ann. §§ 28.001-.010 (West 2000) ("Prompt Pay Act"). On June 17, 2005, the court rendered a final default judgment in favor of Aguado Stone and against Wissen that Wissen was liable to Aguado Stone for $70,888.68 (the balance of Wissen's invoices), $21,566.60 in interest, and $1,353.43 in attorney's fees, for a total of $93,808.80, to accrue postjudgment interest at a rate of 5% compounded annually.

In October 2005, as of Wissen's Chapter 7 bankruptcy filing, Wissen owed Aguado Stone $95,641.57 on the state-court judgment. Aguado Stone commenced the underlying adversary proceeding, seeking a determination that Wissen's Debt is nondischargeable. *See 11 U.S.C. § 523(a)(4)*. By its adversary action, Aguado Stone alleged that Wissen breached **[*4]** his fiduciary duty to Aguado Stone, which arose under the Texas Construction Trust Fund Act. *Tex. Prop. Code Ann. § 162.031* (West 2007). And because Wissen's actions constituted fraud or defalcation while acting in a fiduciary capacity, the Debt is nondichargeable. *See 11 U.S.C. § 523(a)(4)*. The Bankruptcy Court agreed with Aguado Stone and Wissen now challenges the Bankruptcy Court's ruling.

Analysis

A bankruptcy court's determination of whether a debt is dischargeable or whether objections to the dischargeability of a debt should be sustained are core bankruptcy proceedings. *See* 28 U.S.C. § 157(b)(2)(I), (J). When reviewing a bankruptcy court's decision in a core proceeding, the district court functions as an appellate court and applies the standard of review generally applied in federal-court appeals. *See Webb v. Reserve Life Ins. Co., 954 F.2d 1102, 1103-04 (5th Cir. 1992)*. District courts review questions of law from bankruptcy proceedings *de novo* and findings of fact under a clearly erroneous standard. *See Plunk v. Yaquinto, 481 F.3d 302, 305 (5th Cir. 2007)*; *Fed. R. Bankr. P. 8013*.

The parties agree to the applicable provisions of federal and Texas law. As a general policy, bankruptcy **[*5]** law favors permitting a debtor to discharge his debts, thereby affording him a fresh start. *See Boyle v. Abilene Lumber, Inc., 819 F.2d 583, 587 (5th Cir. 1987)*. However, debts predicated on fraud or defalcation while acting in a fiduciary capacity, embezzlement, and larceny are nondischargeable. *11 U.S.C. § 523(a)(4)* ("*Section 523(a)(4)*"). Congress designed the discharge exception to reach "debts incurred through abuses of fiduciary positions and through active misconduct whereby a debtor has deprived others of their property by criminal acts; both classes of conduct involve debts arising from the debtor's acquisition or use of property that is not the debtor's." *Boyle, 819 F.2d at 587-88*.

Although the debtor must initially make a *prima facie* showing that he is entitled to discharge of a debt, it is the creditor who ultimately must prove that the debt falls within the *Section 523(a)(4)* exception. *Garrie v. James L. Gray, Inc., 912 F.2d 808, 811 (5th Cir. 1990)*. Here, the objecting creditor, Aguado Stone had the burden of showing that *Section 523(a)(4)* was applicable to the Debt. *See Fed. R. Bankr. P. 4005*; *Coburn Co. v. Nicholas, 956 F.2d 110, 114 (5th Cir. 1992)*; *Connelly v. Michael, 424 F.2d 387, 389 (5th Cir. 1970)*.

The **[*6]** scope and concept of a fiduciary relationship under *Section 523(a)(4)* is a matter of federal law. *See Angelle v. Reed, 610 F.2d 1335, 1338 (5th Cir. 1980)*. That is to say, not all relationships defined under state law as "fiduciary" are necessarily of the type for which a nondischargeability action will stand under federal bankruptcy law. *See id. at 1341*.

A trust arises under the Texas Construction Trust Fund Act in favor of suppliers in the position of Aguado Stone when contractors such as Wissen receive construction payments for improvements made to specific real property. *See Tex. Prop. Code Ann. §§ 162.001-.003* (West 2007). The trust is discharged when the contractor applies the monies it receives towards payment to the subcontractors or suppliers on the project. *Id.*

A contractor will be held to have "misapplied" trust funds if the contractor-trustee intentionally or knowingly or with intent to defraud, directly or indirectly retains, uses, disburses, or otherwise diverts trust funds without first fully paying all current or past due obligations incurred by the trustee to the beneficiaries of these funds. *See id.* at *§ 162.031(a)*. There is a safe harbor for certain uses of trust funds: **[*7]** "It is an affirmative defense to prosecution or other action brought under *Section (a)* that the trust funds not paid to the beneficiaries of the trust were used by the trustee to pay the trustee's actual expenses directly related to the construction or repair of the improvement." *See id.* at *§ 162.031(b)*.

The Court finds *Coburn Co. v. Nicholas* instructive. *See 956 F.2d at 113*. The *Nicholas* court held that the Texas Construction Trust Fund Act creates a trust in favor of the creditor and if the funds at issue were retained, used, or diverted to any use by the contractor-debtor other than "actual expenses directly related to the construction or repair of the improvement" then the funds were misapplied in a manner actionable under *Section 523(a)(4)*.[3] *Id.*

Based on the facts presented, the *Nicholas* court held there was no violation of *Section 523(a)(4)* because the creditor failed to adduce evidence, either direct or inferential, that any of the funds were misapplied. *Id. at 114*. That is, the *Nicholas* court found that the creditor failed to show that the construction payments were used for anything other than "actual expenses directly related" to the construction project, and thus, no fiduciary relationship existed within the meaning of *Section 523(a)(4)*. *Id.* The *Nicholas* court held that fiduciary duties, as related to the Texas Construction Trust Act, that are encompassed by *Section 523(a)(4)* arise only to the extent wrongful conduct exists under the statute and, as the creditor failed to show that the debtor's company paid construction-payment trust funds to nonbeneficiaries for items other than actual expenses directly related to the construction projects on which the creditor worked, no fiduciary duty existed for purposes of *Section 523(a)(4)*. *Id.*

In this cause, during the adversary proceeding, Wissen testified that the construction payments he received were used to pay expenses of his construction business, without regard **[*9]** to the particular project that generated the income. In an attempt to keep his construction business alive, Wissen routinely received payments from one project and, rather than pay suppliers for that particular project, he would use the funds to pay subcontractors and suppliers on other projects or he would pay the general expenses of his construction business. Construction payments Wissen received from projects in which Aguado Stone supplied its product were treated no differently. Wissen maintains that although he diverted payments received away from specific projects in which he used Aguado Stone's product, because he used the money solely to pay general business expenses or expenses incurred on other construction projects, a fiduciary duty under *Section 523(a)(4)* did not exist, and therefore also lacking was any fraud or defalcation while acting in a fiduciary capacity that would render the Debt nondischargeable.

Here, unlike *Nicholas*, the Court finds that Wissen's testimony, together with the parties' stipulations, establish that Wissen used construction-payment trust funds he received from projects in which Aguado Stone supplied its product, to pay expenses on *other construction* ***[*10]*** *projects* that were not projects for which Aguado Stone supplied product. Although Wissen testified that he never used the payments for anything other than his construction business, he nevertheless paid expenses incurred on other construction jobs with construction payments received from projects in which Aguado Stone's product was used. The Court finds that Wissen misapplied funds that he held in trust for his supplier Aguado Stone for improvements on specific real property. Further, the Court finds, as did the Bankruptcy Court, that because Wissen misapplied Aguado Stone's portion of the construction-payment trust funds, Wissen owed Aguado Stone a fiduciary duty within the meaning of *Section 523(a)(4)*.

Having determined that Wissen owed Aguado Stone a fiduciary duty, the Court determines whether there was fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny. Wissen contends that as he did not intentionally defraud Aguado Stone, therefore, the debt is dischargeable. Assuming without deciding that Wissen did not defraud Agaudo Stone, at issue is whether his actions were a defalcation while acting in the capacity of a fiduciary. Although "defalcation" is **[*11]** not defined in the Bankruptcy Code, the Fifth Circuit has interpreted the term to mean a willful neglect of a fiduciary duty tantamount to recklessness. *See In re Schwager, 121 F.3d 177, 185 (5th Cir. 1997)*.

Again, the Court turns to *Nicholas's* analysis of the Texas Construction Trust Fund Statute, which noted that Texas's amendments to the statute have broadened the scope for finding a misapplication of trust funds, and therefore, the potential grounds for nondischargability under *Section 523(a)(4)* have also broadened. *See 956 F.2d at 114*. Under Texas law, a trustee who acts

[3] Texas law creates a trust fund at the time any construction payments are made to a contractor or subcontractor for the construction of improvements on specific real property, pursuant to *Texas Property Code section 162.001*. Under the applicable federal case law, *Nicholas, 956 F.2d at 114*, for purposes of ***Section 523(a)(4)*** an actionable trust, with a fiduciary duty, arises at the instance the contractor-debtor misapplies the construction **[*8]** payments.

"intentional[ly], or knowingly, or with intent to defraud" misapplies funds. *See* *Tex. Prop. Code Ann. § 162.031(a)*. In this regard, based on Wissen's testimony and the parties' stipulations, the Bankruptcy Court found that Wissen knowingly misapplied construction payments that Wissen received and was holding in trust as a fiduciary for Aguado Stone. This Court agrees and finds that Wissen's actions amounted to defalcation while acting in a fiduciary capacity under *Section 523(a)(4)*.

IT IS ORDERED that Wissen's appeal from the Bankruptcy Court's Adversary No. 06-1032-FM Final Judgment On Complaint To Determine Dischargeability **[*12]** (Bankr. W.D. Tex. March 27, 2007) is **OVERRULED.**

IT IS FURTHER ORDERED that the Bankruptcy Court's Final Judgment On Complaint To Determine Dischargeability rendered March 27, 2007, is **AFFIRMED.**

SIGNED this 11th day of March, 2008.

/s/ Lee Yeakel

LEE YEAKEL

UNITED STATES DISTRICT JUDGE

FINAL JUDGMENT

Before the Court is the above styled and numbered cause of action. On this date by separate order the Court overruled Appellant Kevin Wissen's appeal. Accordingly, the Court renders this Final Judgment pursuant to *Federal Rule of Civil Procedure 58*.

IT IS ORDERED that the appeal of Kevin Wissen is **OVERRULED.**

IT IS FURTHER ORDERED that *Aguado Stone, Inc. v. Wissen*, Adversary No. 06-1032-FM Final Judgment On Complaint To Determine Dischargeability (Bankr. W.D. Tex. March 27, 2007) is **AFFIRMED.**

IT IS FURTHER ORDERED that all relief not expressly granted is hereby **DENIED.**

FINALLY IT IS ORDERED that this action is hereby **CLOSED.**

SIGNED this 11th day of March, 2008.

/s/ Lee Yeakel

LEE YEAKEL

UNITED STATES DISTRICT JUDGE

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