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Substantive Track – Session 2

Theft by Contractor

Presenters:
Kevin D. Trost
Trost LLC, Madison

Micheal D. Hahn
Nowlan Law LLP, Janesville

About the Presenters...

Kevin Trost is the founding member of Trost, LLC, in Madison. He received his undergraduate degree from Washington University, *cum laude*, and his law degree from the University of Wisconsin. Kevin has authored four articles, including three cover articles, for the *Wisconsin Lawyer*. His most recent article is "American Dream Turned Nightmare: Liability for Undisclosed Defects in Real Estate Sales." 94 Wis. Law. 6 (6/2021). For over twenty years, Kevin's practice has focused on litigating and resolving disputes regarding real estate, construction, financial services, banking, and contractual matters. He is a member of the State Bars of Wisconsin and Michigan.

Michael D. Hahn is a trial attorney at Nowland Law LLP. He has represented clients at all levels of the Wisconsin court system and has helped guide clients through municipalities, the Wisconsin Department of Natural Resources, and the Department of Agriculture Trade and Consumer Protection.

THEFT BY CONTRACTOR

Wisconsin Solo & Small Firm Conference
October 22, 2026

Attorney Micheal Hahn
Nowlan Law LLP

1. What is Theft by Contractor? Elements of Claim

2. Proving Civil Theft Claims for Theft by Contractor

3. Pursuing Claims in Bankruptcy

    a. Non-Dischargeability Standards
    b. Practical Concerns
    c. What if there is already a judgment in state court?

136 S.Ct. 1581
Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC., petitioner
v.
Daniel Lee RITZ, Jr.

No. 15–145
|
Argued March 1, 2016.
|
Decided May 16, 2016.

Synopsis

Background: Creditor, a seller of electronic device components, brought adversary proceeding against Chapter 7 debtor, the individual who was in financial control of the company that had purchased components from creditor, seeking to pierce corporate veil in order to hold debtor personally liable on corporate debt, and to except debt from discharge on, inter alia, a "false pretenses, false representation, or actual fraud" theory. Following trial, the United States Bankruptcy Court for the Southern District of Texas, Jeff Bohm, J., 459 B.R. 623, entered judgment in favor of debtor, and creditor appealed. The District Court, Melinda Harmon, J., 513 B.R. 510, affirmed. Creditor appealed. The Court of Appeals for the Fifth Circuit, Carolyn Dineen King, Circuit Judge, 787 F.3d 312, affirmed. Certiorari was granted.

The Supreme Court, Justice Sotomayor, held that the term "actual fraud," as used in the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.

Reversed and remanded.

Justice Thomas filed a dissenting opinion.

Procedural Posture(s): On Appeal.

****1583** *Syllabus* [*]

***355** Chrysalis Manufacturing Corp. incurred a debt to petitioner Husky International Electronics, Inc., of nearly $164,000. Respondent Daniel Lee Ritz, Jr., Chrysalis' director and part owner at the time, drained Chrysalis of assets available to pay the debt by transferring large sums of money to other entities Ritz controlled. Husky sued Ritz to recover on the debt. Ritz then filed for Chapter 7 bankruptcy, prompting Husky to file a complaint in Ritz' bankruptcy case, seeking to hold him personally liable and contending that the debt was not dischargeable because Ritz' intercompany-transfer scheme constituted "actual fraud" under the Bankruptcy Code's discharge exceptions. 11 U.S.C. § 523(a)(2)(A).

The District Court held that Ritz was personally liable under state law but also held that the debt was not "obtained by ... actual fraud" under § 523(a)(2)(A) and thus could be discharged in bankruptcy. The Fifth Circuit affirmed, holding that a misrepresentation from a debtor to a creditor is a necessary element of "actual fraud" and was lacking in this case, because Ritz made no false representations to Husky regarding the transfer of Chrysalis' assets.

Held : The term "actual fraud" in § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation. Pp. 1586 – 1590.

****1584** (a) It is sensible to presume that when Congress amended the Bankruptcy Code in 1978 and added to debts obtained by "false pretenses or false representations" an additional bankruptcy discharge exception for debts obtained by "actual fraud," it did not intend the term "actual fraud" to mean the same thing as the already-existing term "false representations." See *United States v. Quality Stores, Inc.,* 572 U.S. ——, ——, 134 S.Ct. 1395, 188 L.Ed.2d 413. Even stronger evidence that "actual fraud" encompasses the kind of conduct alleged to have occurred here is found in the phrase's historical meaning. At common law, "actual fraud" meant fraud committed with wrongful intent, *Neal v. Clark,* 95 U.S. 704, 709, 24 L.Ed. 586. And the term "fraud" has, since the beginnings of bankruptcy practice, been used to describe asset transfers that, like Ritz' scheme, impair a creditor's ability to collect a debt.

***356** One of the first bankruptcy Acts, the Fraudulent Conveyances Act of 1571, 13 Eliz., ch. 5, identified as "fraud" conveyances made with "[i]ntent to delay hynder or defraude [c]reditors." The degree to which that statute remains embedded in fraud-related laws today, see, *e.g., BFP v. Resolution Trust Corporation,* 511 U.S. 531, 540, 114

S.Ct. 1757, 128 L.Ed.2d 556, clarifies that the common-law term "actual fraud" is broad enough to incorporate fraudulent conveyances. The common law also indicates that fraudulent conveyances do not require a misrepresentation from a debtor to a creditor, see *id.,* at 541, 114 S.Ct. 1757 as they lie not in dishonestly inducing a creditor to extend a debt but in the acts of concealment and hindrance. Pp. 1586 – 1588.

(b) Interpreting "actual fraud" in § 523(a)(2)(A) to encompass fraudulent conveyances would not, as Ritz contends, render duplicative two of § 523's other discharge exceptions, §§ 523(a)(4), (6), given that "actual fraud" captures much conduct not covered by those other provisions. Nor does this interpretation create a redundancy in § 727(a)(2), which is meaningfully different from § 523(a)(2)(A). It is also not incompatible with § 523(a)(2)(A)'s "obtained by" requirement. Even though the transferor of a fraudulent conveyance does not obtain assets or debts through the fraudulent conveyance, the transferee—who, with the requisite intent, also commits fraud—does. At minimum, those debts would not be dischargeable under § 523(a)(2)(A). Finally, reading the phrase "actual fraud" to restrict, rather than expand, the discharge exception's reach would untenably require reading the disjunctive "or" in the phrase "false pretenses, a false representation, or actual fraud" to mean "by." Pp. 1588 – 1590.

787 F.3d 312, reversed and remanded.

SOTOMAYOR, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, GINSBURG, BREYER, ALITO, and KAGAN, JJ., joined. THOMAS, J., filed a dissenting opinion.

Attorneys and Law Firms

Shay Dvoretzky, Washington, DC, for petitioner.

Sarah E. Harrington, for the United States as amicus curiae, by special leave of the Court, supporting the petitioner.

Erin E. Murphy, Washington, DC, for the respondent.

Jeffrey L. Dorrell, Hanszen Laporte, Houston, TX, Shay Dvoretzky, Christopher DiPompeo, Anthony J. Dick, Emily J. Kennedy, Jones Day, Washington, DC, for petitioner.

William D. Weber, Weber Law Firm, P.C., Houston, TX, Erin E. Murphy, Stephen V. Potenza, Andrew N. Ferguson, ****1585** Bancroft PLLC, Washington, DC, for respondent.

Opinion

Justice SOTOMAYOR delivered the opinion of the Court.

***357** The Bankruptcy Code prohibits debtors from discharging debts "obtained by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). The Fifth Circuit held that a debt is "obtained by ... actual fraud" only if the debtor's fraud involves a false representation to a creditor. That ruling deepened an existing split among the Circuits over whether "actual fraud" requires a false representation or whether it encompasses other traditional forms of fraud that can be accomplished without a false representation, such as a fraudulent conveyance of property made to evade payment to creditors. We granted certiorari to resolve that split and now reverse.

I

Husky International Electronics, Inc., is a Colorado-based supplier of components used in electronic devices. Between 2003 and 2007, Husky sold its products to Chrysalis Manufacturing Corp., and Chrysalis incurred a debt to Husky of $163,999.38. During the same period, respondent Daniel Lee Ritz, Jr., served as a director of Chrysalis and owned at least 30% of Chrysalis' common stock.

***358** All parties agree that between 2006 and 2007, Ritz drained Chrysalis of assets it could have used to pay its debts to creditors like Husky by transferring large sums of Chrysalis' funds to other entities Ritz controlled. For instance—and Ritz' actions were by no means limited to these examples—Ritz transferred $52,600 to CapNet Risk Management, Inc., a company he owned in full; $121,831 to CapNet Securities Corp., a company in which he owned an 85% interest; and $99,386.90 to Dynalyst Manufacturing Corp., a company in which he owned a 25% interest.

In May 2009, Husky filed a lawsuit against Ritz seeking to hold him personally responsible for Chrysalis' $163,999.38 debt. Husky argued that Ritz' intercompany-transfer scheme was "actual fraud" for purposes of a Texas law that allows creditors to hold shareholders responsible for corporate debt. See Tex. Bus. Orgs. Code Ann. § 21.223(b) (West 2012). In December 2009, Ritz filed for Chapter 7 bankruptcy in the United States Bankruptcy Court for the Southern District of Texas. Husky then initiated an adversarial proceeding in Ritz' bankruptcy case again seeking to hold Ritz personally

liable for Chrysalis' debt. Husky also contended that Ritz could not discharge that debt in bankruptcy because the same intercompany-transfer scheme constituted "actual fraud" under 11 U.S.C. § 523(a)(2)(A)'s exemption to discharge. [1]

The District Court held that Ritz was personally liable for the debt under Texas law, but that the debt was not "obtained by ... actual fraud" under § 523(a)(2)(A) and could be discharged in his bankruptcy.

The Fifth Circuit affirmed. It did not address whether Ritz was responsible for Chrysalis' debt under Texas law because ***359** it agreed with the District Court that Ritz ****1586** did not commit "actual fraud" under § 523(a)(2) (A). Before the Fifth Circuit, Husky argued that Ritz' asset-transfer scheme was effectuated through a series of fraudulent conveyances—or transfers intended to obstruct the collection of debt. And, Husky said, such transfers are a recognizable form of "actual fraud." The Fifth Circuit disagreed, holding that a necessary element of "actual fraud" is a misrepresentation from the debtor to the creditor, as when a person applying for credit adds an extra zero to her income or falsifies her employment history. *In re Ritz,* 787 F.3d 312, 316 (2015). In transferring Chrysalis' assets, Ritz may have hindered Husky's ability to recover its debt, but the Fifth Circuit found that he did not make any false representations to Husky regarding those assets or the transfers and therefore did not commit "actual fraud."

We reverse. The term "actual fraud" in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.

II

A

Before 1978, the Bankruptcy Code prohibited debtors from discharging debts obtained by "false pretenses or false representations." § 35(a)(2) (1976 ed.). In the Bankruptcy Reform Act of 1978, Congress added "actual fraud" to that list. 92 Stat. 2590. The prohibition now reads: "A discharge under [Chapters 7, 11, 12, or 13] of this title does not discharge an individual debtor from any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud." § 523(a)(2)(A) (2012 ed.).

When " 'Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.' " ***360** *United States v. Quality Stores, Inc.,* 572 U.S. ——, ——, 134 S.Ct. 1395, 1401, 188 L.Ed.2d 413 (2014). It is therefore sensible to start with the presumption that Congress did not intend "actual fraud" to mean the same thing as "a false representation," as the Fifth Circuit's holding suggests. But the historical meaning of "actual fraud" provides even stronger evidence that the phrase has long encompassed the kind of conduct alleged to have occurred here: a transfer scheme designed to hinder the collection of debt.

This Court has historically construed the terms in § 523(a)(2)(A) to contain the "elements that the common law has defined them to include." *Field v. Mans,* 516 U.S. 59, 69, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). "Actual fraud" has two parts: actual and fraud. The word "actual" has a simple meaning in the context of common-law fraud: It denotes any fraud that "involv[es] moral turpitude or intentional wrong." *Neal v. Clark,* 95 U.S. 704, 709, 24 L.Ed. 586 (1878). "Actual" fraud stands in contrast to "implied" fraud or fraud "in law," which describe acts of deception that "may exist without the imputation of bad faith or immorality." *Ibid.* Thus, anything that counts as "fraud" and is done with wrongful intent is "actual fraud."

Although "fraud" connotes deception or trickery generally, the term is difficult to define more precisely. See 1 J. Story, Commentaries on Equity Jurisprudence § 189, p. 221 (6th ed. 1853) (Story) ("Fraud ... being so various in its nature, and so extensive in its application to human concerns, it would be difficult to enumerate all the instances in which Courts of ****1587** Equity will grant relief under this head"). There is no need to adopt a definition for all times and all circumstances here because, from the beginning of English bankruptcy practice, courts and legislatures have used the term "fraud" to describe a debtor's transfer of assets that, like Ritz' scheme, impairs a creditor's ability to collect the debt.

One of the first bankruptcy acts, the Statute of 13 Elizabeth, has long been relied upon as a restatement of the law of so-called fraudulent conveyances (also known as "fraudulent transfers" or "fraudulent alienations"). See generally G. ***361** Glenn, The Law of Fraudulent Conveyances 89–92 (1931). That statute, also called the Fraudulent Conveyances Act of 1571, identified as fraud "faigned covenous and fraudulent Feoffmentes Gyftes Grauntes Alienations [and] Conveyaunces" made with "Intent to delaye hynder or

defraude Creditors." 13 Eliz. ch. 5. In modern terms, Parliament made it fraudulent to hide assets from creditors by giving them to one's family, friends, or associates. The principles of the Statute of 13 Elizabeth—and even some of its language—continue to be in wide use today. See *BFP v. Resolution Trust Corporation,* 511 U.S. 531, 540, 114 S.Ct. 1757, 128 L.Ed.2d 556 (1994) ("The modern law of fraudulent transfers had its origin in the Statute of 13 Elizabeth"); *id.,* at 541, 114 S.Ct. 1757 ("Every American bankruptcy law has incorporated a fraudulent transfer provision"); Story § 353, at 393 ("[T]he statute of 13 Elizabeth ... has been universally adopted in America, as the basis of our jurisprudence on the same subject"); *Boston Trading Group, Inc. v. Burnazos,* 835 F.2d 1504, 1505–1506 (C.A.1 1987) (Breyer, J.) ("Mass. Gen. Laws ch. 109A, §§ 1–13 ... is a uniform state law that codifies both common and statutory law stretching back at least to 1571 and the Statute of Elizabeth"). The degree to which this statute remains embedded in laws related to fraud today clarifies that the common-law term "actual fraud" is broad enough to incorporate a fraudulent conveyance.

Equally important, the common law also indicates that fraudulent conveyances, although a "fraud," do not require a misrepresentation from a debtor to a creditor. As a basic point, fraudulent conveyances are not an inducement-based fraud. Fraudulent conveyances typically involve "a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration." *BFP,* 511 U.S., at 540–541, 114 S.Ct. 1757 (citing *Twyne's Case,* 3 Co. Rep. 80b, 76 Eng. Rep. 809 (K.B. 1601)); O. Bump, Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors To Defraud Creditors 31–60 (3d ed. 1882). In such ***362** cases, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the acts of concealment and hindrance. In the fraudulent-conveyance context, therefore, the opportunities for a false representation from the debtor to the creditor are limited. The debtor may have the opportunity to put forward a false representation if the creditor inquires into the whereabouts of the debtor's assets, but that could hardly be considered a defining feature of this kind of fraud.

Relatedly, under the Statute of 13 Elizabeth and the laws that followed, both the debtor and the recipient of the conveyed assets were liable for fraud even though the recipient of a fraudulent conveyance of course made no representation, true or false, to the debtor's creditor. The famous *Twyne's Case,* which this Court relied upon in *BFP,* illustrates this point. See *Twyne's Case,* 76 Eng. Rep., at 823 (convicting Twyne of fraud under the Statute of 13 Elizabeth, even though he was ****1588** the recipient of a debtor's conveyance). That principle underlies the now-common understanding that a "conveyance which hinders, delays or defrauds creditors shall be void as against [the recipient] unless ... th[at] party ... received it in good faith and for consideration." Glenn, Law of Fraudulent Conveyances § 233, at 312. That principle also underscores the point that a false representation has never been a required element of "actual fraud," and we decline to adopt it as one today.

B

Ritz concedes that fraudulent conveyances are a form of "actual fraud,"[2] but contends that 11 U.S.C. § 523(a)(2)(A)'s particular use of the phrase means something else. Ritz' strained reading of the provision finds little support.

***363** First, Ritz contends that interpreting "actual fraud" in § 523(a) (2)(A) to encompass fraudulent conveyances would render duplicative two other exceptions to discharge in § 523. Section 523(a)(4) exempts from discharge "any debt ... for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." And § 523(a)(6) exempts "any debt ... for willful and malicious injury by the debtor to another entity or to the property of another entity."

Ritz makes the unremarkable point that the traditional definition of "actual fraud" will cover some of the same conduct as those exceptions: for example, a trustee who fraudulently conveys away his trust's assets. But Ritz' interpretation does not avoid duplication, nor does our interpretation fail to preserve a meaningful difference between § 523(a)(2)(A) and §§ 523(a)(4), (6). Just as a fiduciary who engages in a fraudulent conveyance may find his debt exempted from discharge under either § 523(a)(2)(A) or § 523(a)(4), so too would a fiduciary who engages in one of the fraudulent misrepresentations that form the core of Ritz' preferred interpretation of § 523(a)(2)(A). The same is true for § 523(a)(6). The debtors who commit fraudulent conveyances *and* the debtors who make false representations under § 523(a)(2)(A) could likewise also inflict "willful and malicious injury" under § 523(a)(6). There is, in short, overlap, but that overlap appears inevitable.

And, of course, our interpretation of "actual fraud" in § 523(a)(2)(A) also preserves meaningful distinctions between

that provision and §§ 523(a)(4), (a)(6). Section 523(a)(4), for instance, covers only debts for fraud while acting as a fiduciary, whereas § 523(a)(2)(A) has no similar limitation. Nothing in our interpretation alters that distinction. And § 523(a)(6) covers debts "for willful and malicious injury," whether or not that injury is the result of fraud, see *Kawaauhau v. Geiger,* 523 U.S. 57, 61, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998) (discussing injuries resulting from " 'intentional torts' "), whereas § 523(a)(2)(A) covers only fraudulent acts. Nothing in our interpretation ***364** alters that distinction either. Thus, given the clear differences between these provisions, we see no reason to craft an artificial definition of "actual fraud" merely to avoid narrow redundancies in § 523 that appear unavoidable.

Ritz also says that our interpretation creates redundancy with a separate section of the Bankruptcy Code, § 727(a)(2), which prevents a debtor from discharging all of his debts if, within the ****1589** year preceding the bankruptcy petition, he "transferred, removed, destroyed, mutilated, or concealed" property "with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property." Although the two provisions could cover some of the same conduct, they are meaningfully different. Section 727(a)(2) is broader than § 523(a)(2)(A) in scope—preventing an offending debtor from discharging all debt in bankruptcy. But it is narrower than § 523(a)(2)(A) in timing—applying only if the debtor fraudulently conveys assets in the year preceding the bankruptcy filing. In short, while § 727(a)(2) is a blunt remedy for actions that hinder the entire bankruptcy process, § 523(a)(2)(A) is a tailored remedy for behavior connected to specific debts.

Ritz' next point of resistance rests on § 523(a)(2)(A)'s requirement that the relevant debt be "for money, property, services, or ... credit ... *obtained by* ... actual fraud." (Emphasis added.) The argument, which the dissent also emphasizes, has two parts: First, it posits that fraudulent conveyances (unlike other forms of actual fraud) cannot be used to "obtai[n]" debt because they function instead to hide valuables that a debtor already possesses. Brief for Respondent 20, 31. There is, the dissent says, no debt at the end of a fraudulent conveyance that could be said to " 'resul[t] from' " or be " 'traceable to' " the fraud. *Post,* at 1591 (quoting *Field,* 516 U.S., at 61, 64, 116 S.Ct. 437). Second, it urges that "actual fraud" not be interpreted to encompass forms of fraud that are incompatible with the provision's "obtained by" requirement.

***365** It is of course true that the transferor does not "obtai[n]" debts in a fraudulent conveyance. But the recipient of the transfer—who, with the requisite intent, also commits fraud—can "obtai[n]" assets "by" his or her participation in the fraud. See, *e.g.*, *McClellan* v. *Cantrell,* 217 F.3d 890 (C.A.7 2000); see also *supra,* at 1587 – 1588. If that recipient later files for bankruptcy, any debts " traceable to" the fraudulent conveyance, see *Field,* 516 U.S., at 61, 116 S.Ct. 437; *post,* at 1591, will be nondischargable under § 523(a)(2)(A). Thus, at least sometimes a debt "obtained by" a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A). Such circumstances may be rare because a person who receives fraudulently conveyed assets is not necessarily (or even likely to be) a debtor on the verge of bankruptcy,[3] BUT THEY MAKE Clear that fraudulent conveyances are not wholly incompatible with the "obtained by" requirement.

The dissent presses further still, contending that the phrase "obtained by ... actual fraud" requires not only that the relevant debts "resul [t] from" or be "traceable to" fraud but also that they "result from fraud *at the inception of a credit transaction*." *Post,* at 1591 (emphasis added). Nothing in the text of § 523(a)(2)(A) supports that additional requirement. The dissent bases its conclusion on this Court's opinion in *Field,* in which the Court noted that certain forms of bankruptcy fraud require a degree of direct reliance by a creditor on an action taken by a debtor. But *Field* discussed such "reliance" only in setting forth the requirements of the form of fraud alleged in that case—namely, fraud perpetrated through a misrepresentation to a creditor. ****1590** See 516 U.S., at 61, 116 S.Ct. 437. The Court was not establishing a " reliance" ***366** requirement for frauds that are not premised on such a misrepresentation.

Finally, Ritz argues that Congress added the phrase "actual fraud" to § 523(a)(2)(A) not to expand the exception's reach, but to restrict it. In Ritz' view, "actual fraud" was inserted as the last item in a disjunctive list—"false pretenses, a false representation, *or* actual fraud"—in order to make clear that the "false pretenses" and "false representation[s]" covered by the provision needed to be intentional. Brief for Respondent 29–31. Ritz asks us, in other words, to ignore what he believes is Congress' "imprudent use of the word 'or,' " *id.*, at 32, and read the final item in the list to modify and limit the others. In essence, he asks us to change the word "or" to "by." That is an argument that defeats itself. We can think of no other example, nor could petitioner point to any at oral argument, in which this Court has attempted such an unusual statutory modification.

* * *

Because we must give the phrase "actual fraud" in § 523(a)(2)(A) the meaning it has long held, we interpret "actual fraud" to encompass fraudulent conveyance schemes, even when those schemes do not involve a false representation. We therefore reverse the judgment of the Fifth Circuit and remand the case for further proceedings consistent with this opinion.

So ordered.

Justice THOMAS, dissenting.

The Bankruptcy Code exempts from discharge "any debt ... for money, property, [or] services ... *to the extent obtained by* ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A) (emphasis added). The Court holds that "actual fraud" encompasses fraudulent transfer schemes effectuated without any false representation to a creditor and concludes that a debt for goods may ***367** "sometimes" be "obtained by" a fraudulent transfer scheme. *Ante,* at 1585 – 1586, 1589. Because § 523(a)(2)(A) does not apply so expansively, I respectfully dissent.

I

In my view, "actual fraud" within the meaning of § 523(a)(2) does not encompass fraudulent transfer schemes. There are two types of fraudulent transfer schemes: "transfers made with actual intent to hinder, delay, or defraud creditors, referred to as actual fraudulent transfers" and "transfers made for less than reasonably equivalent value when a debtor was in financial trouble, [which is] referred to as constructive fraudulent transfers." 2 Bankruptcy Law Manual § 9A:29, p. 333 (5th ed. 2015). I do not quibble with the majority's conclusion that the *common-law* definition of "actual fraud" included fraudulent transfers. *Ante,* at 1586 – 1588. And I agree that, generally, we should give a common-law term of art its established common-law meaning. *Ante,* at 1586. Nevertheless, the "general rule that a common-law term of art should be given its established common-law meaning" gives way "where that meaning does not fit." *United States v. Castleman,* 572 U.S. ——, ——, 134 S.Ct. 1405, 1410, 188 L.Ed.2d 426 (2014) (internal quotation marks omitted). Ultimately, "[s]tatutory language must be read in context and a phrase gathers meaning from the words around it." *Jones v. United States,* 527 U.S. 373, 389, 119 S.Ct. 2090, 144 L.Ed.2d 370 (1999) (internal quotation marks omitted). In my view, context dictates that "actual fraud" ordinarily does not include fraudulent transfers because "that meaning does not fit" with the rest of § 523(a)(2). ****1591** *Castleman, supra,* at ——, 134 S.Ct., at 1410 (internal quotation marks omitted).

Section 523(a)(2) covers only situations in which "money, property, [or] services" are "obtained by ... actual fraud," and results in a debt. See *Cohen v. de la Cruz,* 523 U.S. 213, 218, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998). The statutory phrase "obtained by" is an important limitation on the reach of the provision. Section 523(a)(2)(A) applies only when the fraudulent conduct occurs ***368** at the *inception of the debt, i.e.,* when the debtor commits a fraudulent act to induce the creditor to part with his money, property, services, or credit. The logical conclusion then is that " actual fraud"—as it is used in the statute—covers only those situations in which some sort of fraudulent conduct caused the creditor to enter into a transaction with the debtor. A fraudulent transfer generally does not fit that mold, unless, perhaps, the fraudulent transferor and the fraudulent transferee conspired to fraudulently drain the assets of the creditor. But the fraudulent transfer here, like all but the rarest fraudulent transfers, did not trick the creditor into selling his goods to the buyer, Chrysalis Manufacturing Corporation. It follows that the goods that resulted in the debt here were not "obtained by" actual fraud. § 523(a)(2)(A).

A

I reach this conclusion based on the plain meaning of the phrase "obtained by," which has an "inherent" "element of causation," and refers to those debts "resulting from" or "traceable to" fraud. *Field v. Mans,* 516 U.S. 59, 61, 64, 66, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). As I have stated, "in order for a creditor to establish that a debt is not dischargeable, he must demonstrate that there is a causal nexus between the fraud and the debt." *Archer v. Warner,* 538 U.S. 314, 325, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003) (THOMAS, J., dissenting) (relying on *Field, supra,* at 61, 64, 116 S.Ct. 437 and *Cohen, supra,* at 218, 118 S.Ct. 1212). There is also "[n]o ... doub[t] that some degree of reliance is required to satisfy th[is] element of causation." *Field,* 516 U.S., at 66, 116 S.Ct. 437. The upshot of the phrase "obtained by" is that § 523(a)(2) covers only those debts that result from fraud at the inception of a credit transaction. Such a debt caused by fraud necessarily "*follows* a transfer of value or extension of credit induced by falsity or fraud." *Ibid.* (emphasis added).

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Bankruptcy treatises confirm that "[t]he phrase 'to the extent obtained by' is properly read as meaning 'obtained from' the creditor." ***369** 3 W. Norton & W. Norton, Bankruptcy Law and Practice § 57:15, p. 57–35 (3d ed. 2015). The "term 'by' refers to the manner in which such money, property, services is obtained and the creditor defrauded." *Ibid.* According to Collier on Bankruptcy, to invoke § 523(a)(2)(A) based on "actual fraud," a creditor "must establish" that he "justifiably relied" on the debtor's "representation," which the debtor "knew to be false" and made "with the intent and purpose of deceiving the" creditor and that the creditor "sustained a loss or damage as the proximate consequence." 4 Collier on Bankruptcy ¶ 523.08[1][e], p. 523–47 (A. Resnick & H. Sommer eds., 16th ed. 2015). Norton Bankruptcy Law and Practice is in accord: Section 523(a)(2)(A) requires a "misrepresentation," "knowledge of falsity," "intent to defraud," "justifiable reliance," and "resulting damage." 3 Norton, *supra,* § 57:15, at 57–33 to 57–34.

B

Applying those principles here, Husky cannot invoke § 523(a)(2)(A) to except the debt owed to it from discharge because, ordinarily, it would be nonsensical to say ****1592** that a fraudulent transfer created the debt at issue. As the majority notes, the debt at issue did not originate from any transaction between Ritz and Husky. *Ante,* at 1585. Instead, Husky sold goods to Chrysalis, a company that Ritz financially controlled. *Ibid*. In turn, Chrysalis—not Ritz—incurred a debt to Husky of $163,999.38 for the goods. *Ante,* at 1585. As the Bankruptcy Court found, there is no evidence that Ritz made "any oral or written representations to Husky inducing Husky to enter into a contract with Chrysalis." *In re Ritz,* 459 B.R. 623, 628 (S.D.Tex.2011). In fact, the only communication between Ritz and Husky occurred after Husky and Chrysalis entered into the contract and after Husky had shipped the goods to Chrysalis. *Ibid.* The Bankruptcy Court also found that there was no evidence that Ritz transferred the funds to avoid Chrysalis' obligations to pay the debt it owed to Husky —an unsecured creditor. ***370** *Id.,* at 635. Because Husky does not contend that Ritz fraudulently induced it to sell goods to Chrysalis and cannot show that the constructive fraudulent conveyance had anything to do with its decision to contract with Chrysalis, Husky has not established that § 523(a)(2)(a) covers any debt owed to it.

II

The majority reaches the opposite conclusion and holds that § 523(a)(2) may prevent an individual debtor from obtaining a discharge even if (1) the debtor makes no false representation to the creditor, (2) the creditor does not rely on any of the debtor's actions or inactions, and (3) there was no actual fraudulent conveyance at the inception of the credit transaction between the creditor and the debtor. *Ante,* at 1587 – 1588, 1589. It does so by giving new meaning to the phrase "obtained by" in cases involving fraudulent transfers, disregarding our case law, and second-guessing Congress' choices. *Ante,* at 1589.

The majority admits that a transferor "does not 'obtai[n]' debts in a fraudulent conveyance," but contends that "the recipient of the transfer—who, with the requisite intent, also commits fraud—can 'obtain' assets 'by' his or her participation in the fraud." *Ibid.* (brackets omitted). "If that recipient later files for bankruptcy, any debts traceable to the fraudulent conveyance," the majority states, "will be nondischargable under § 523(a)(2)(A)." *Ibid.* (internal quotation marks omitted). The majority thus holds that "at least sometimes a debt 'obtained by' a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A)." *Ibid.* But § 523(a)(2)(A) does not exempt from discharge any debts "traceable to the fraudulent conveyance." Instead, § 523(a)(2)(A) exempts from discharge "any debt for" goods that are "obtained by" actual fraud. And, as explained, it is extremely rare that a creditor will use an actual fraudulent transfer scheme to induce a creditor to depart with property, services, money, or credit. See *supra,* at 1590 – 1591.

***371** In reaching its conclusion, the majority also disregards this Court's precedents interpreting § 523(a)(2)(A), presumably because those cases did not involve fraudulent transfers. The majority cites *Field* only for the elemental proposition that this Court "has historically construed the terms in § 523(a)(2)(A) to contain the 'elements that the common law has defined them to include.' " *Ante,* at 1586 (quoting 516 U.S., at 69, 116 S.Ct. 437). The majority omits *Field* 's conclusion that one of the elements of "actual fraud" in § 523(a)(2)(A) is "*reliance* " on some sort of false statement, misrepresentation, or omission. *Id*., at 70, 116 S.Ct. 437 (emphasis added). To be sure, like the rest of our cases interpreting § 523(a)(2)(A), *Field* involves ****1593** a false statement. But that factual distinction is immaterial. Cases like *Field*—which interpret the phrase "obtained by"—

are as relevant in cases that involve false statements and misrepresentations as they are in a case like this one. After all, "obtained by" modifies false pretenses, false representations, and actual fraud in § 523(a)(2)(A). And in no case has this Court suggested—never mind held—that § 523(a)(2)(A) may apply to circumstances in which there was no false statement, misrepresentation, or omission when the debt was first obtained.

The majority ostensibly creates a new definition of "obtained by" because it thinks that this move is necessary to avoid rendering "actual fraud" superfluous. See *ante,* at 1586, 1588 – 1589. Not so. Actual fraud is broader than false pretenses or false representations, and "consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another." 4 Collier on Bankruptcy ¶ 523.08 [1][e], at 523–46. "Unlike false pretenses or false representation, actual fraud, within the meaning of the dischargeability exception, can focus on a promise of future performance made with intent not to perform." 2F Bankruptcy Service § 27:211, p. 59 (Supp. Jan. 2016). In this way, "the actual fraud" exception "permit[s] the courts to except from discharge debts incurred without intent to ***372** repay, or by use of other false implied representations, without the need to stretch the false pretenses and false representations language." Zaretsky, The Fraud Exception to Discharge Under the New Bankruptcy Code, 53 Am. Bankruptcy L.J. 253, 257 (1979). Some courts, for example, have held that "a debtor commits actual fraud within the meaning of § 523(a)(2)(A) when he incurs credit card debt with no actual, subjective intent to repay it," but has not made an affirmatively false representation or engaged in false pretense. *In re Morrow,* 488 B.R. 471, 479–480 (Bkrtcy.Ct.N.D.Ga.2012); see also, *e.g., In re Alam,* 314 B.R. 834, 841 (Bkrtcy.Ct.N.D.Ga.2004). Defining actual fraud this way does not render that term superfluous and—unlike the majority's definition—does not render " obtained by" a nullity.

Regardless, even if there is some overlap between the definitions of "false pretenses," "false representations," and "actual fraud," "[r]edundancies across statutes are not unusual events in drafting." *Connecticut Nat. Bank v. Germain,* 503 U.S. 249, 253, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992). "[T]he canon against surplusage assists only where a competing interpretation gives effect to every clause and word of a statute." *Marx v. General Revenue Corp.,* 568 U.S. ——, ——, 133 S.Ct. 1166, 1177, 185 L.Ed.2d 242 (2013) (internal quotation marks omitted). "But, in this case, no interpretation of [§ 523(a)(2)(A)] gives effect to every word." *Ibid.* Under either my reading or the majority's reading, "actual fraud" is broader than and subsumes "false pretenses" and "false representations." Accordingly, that "actual fraud" may introduce some redundancy in the statute is not dispositive.

At bottom, the majority's attempt to broaden § 523(a)(2)(A) to cover fraudulent transfers impermissibly second-guesses Congress' choices. When Congress wants to stop a debtor from discharging a debt that he has concealed through a fraudulent transfer scheme, it ordinarily says so. See § 727(a)(2) (stating that a court shall grant the debtor a discharge unless the debtor engages in an actual fraudulent transfer scheme within a certain time of filing a bankruptcy ***373** petition). If Congress wanted § 523(a)(2)(A) to cover fraudulent transfer situations, "it would have spoken more clearly to that effect." ****1594** *Staples v. United States,* 511 U.S. 600, 620, 114 S.Ct. 1793,128 L.Ed.2d 608 (1994). Ultimately, "it is not for us to substitute our view of policy for the legislation which has been passed by Congress." *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.,* 554 U.S. 33, 52, 128 S.Ct. 2326, 171 L.Ed.2d 203 (2008) (ellipsis and internal quotation marks omitted).

* * *

The majority today departs from the plain language of § 523(a)(2)(A), as interpreted by our precedents. Because I find no support for the Court's conclusion in the text of the Bankruptcy Code, I respectfully dissent.

All Citations

578 U.S. 355, 136 S.Ct. 1581, 194 L.Ed.2d 655, 84 USLW 4270, 75 Collier Bankr.Cas.2d 943, 62 Bankr.Ct.Dec. 156, Bankr. L. Rep. P 82,943, 14 Cal. Daily Op. Serv. 5016, 2016 Daily Journal D.A.R. 4574, 26 Fla. L. Weekly Fed. S 135

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 Husky also alleged that Ritz' debt should be exempted from discharge under two other exceptions, see 11 U.S.C. § 523(a)(4) (excepting debts for fraud "while acting in a fiduciary capacity"); § 523(a)(6) (excepting debts for "willful and malicious injury"), but does not press those claims in this petition.

2 See Tr. of Oral Arg. 30 (Justice KAGAN: "[Y]ou're not contesting that fraudulent conveyance is a form of actual fraud; is that right?" Ms. Murphy: "[Y]es, that's right"); *id.,* at 27 (Ms. Murphy: "[T]o be clear, we don't dispute that fraudulent conveyance is a form of actual fraud").

3 Ritz' situation may be unusual in this regard because Husky contends that Ritz was both the transferor and the transferee in his fraudulent conveyance scheme, having transferred Chrysalis assets to other companies he controlled. We take no position on that contention here and leave it to the Fifth Circuit to decide on remand whether the debt to Husky was "obtained by" Ritz' asset-transfer scheme.

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456 B.R. 391
United States Bankruptcy Court, E.D. Wisconsin.

In re Jeff L. CARLSON, Debtor.
Baytherm Insulation, Inc., Plaintiff,
v.
Jeff L. Carlson, Defendant.

Bankruptcy No. 10–38400
|
Adversary No. 10–2702
|
Aug. 30, 2011.

Synopsis
Background: In case converted from Chapter 13 to Chapter 7, judgment creditor, a subcontractor, filed adversary complaint against debtor-prime contractor, seeking determination that judgment debt was nondischargeable. Plaintiff moved for summary judgment.

Holdings: The Bankruptcy Court, Margaret Dee McGarity, J., held that:

under Wisconsin law, issue preclusion did not apply to the issue of debtor's criminal intent to defraud, and

damages arising from a debtor's violation of Wisconsin's "theft by contractor" statute fall within the discharge exception for fiduciary defalcation, without any further showing of lack of care or wrongful intent on the debtor's part.

Motion granted.

Procedural Posture(s): Motion for Summary Judgment.

Attorneys and Law Firms

***393** Thomas J. Wroblewski, Menasha, WI, for Plaintiff.

Timothy J. Helbing, Helbing Law Office LLC, Appleton, WI, for Defendant.

MEMORANDUM DECISION ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

MARGARET DEE McGARITY, Bankruptcy Judge.

The plaintiff, Baytherm Insulation, Inc., brought this adversary proceeding objecting to the dischargeability of certain obligations incurred by the defendant, Jeff Carlson. After the defendant filed his answer, the plaintiff moved for summary judgment asserting it was entitled to a nondischargeable judgment pursuant to 11 U.S.C. § 523(a)(4).

This Court has jurisdiction under 28 U.S.C. § 1334 and this is a core proceeding under 28 U.S.C. § 157(b)(2)(I). This decision constitutes the Court's findings of fact and conclusions of law under Fed. R. Bankr.P. 7052. For the reasons stated herein, the plaintiff's motion for summary judgment is granted.

BACKGROUND

The debtor owned and operated a sole proprietorship business known as Carlson Homes and, at all times relevant to this proceeding, acted as a prime contractor on ***394** two construction projects. In the spring and fall of 2008, the debtor requested that Baytherm Insulation, Inc., as subcontractor, supply labor and insulation materials for improvement of properties in Collins and Kaukauna, Wisconsin. The debtor received payment in full from the owners of both properties but never paid Baytherm.

On or about April 15, 2009, Baytherm filed an Amended Summons and Amended Complaint in the Calumet County Circuit Court, alleging, among other things, theft by contractor in violation of section 779.02(5), Wis. Stats. The parties later entered into a Stipulation for Dismissal of the suit which read as follows:

> IT IS STIPULATED and agreed by the Plaintiff, by its attorney, and the Defendant that the Complaint filed in this action should be dismissed not on the merits, without prejudice, without fees or costs, and subject to Plaintiff's right to reopen and take judgment on the following terms and conditions:
>
> 1. Defendant shall pay the aggregate sum of $6,019.94 to Plaintiff as follows:

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a. Six (6) monthly installments in the amount of $150.00, due on the first day of each month, commencing July 1, 2009, ending December 1, 2009;

b. Sixteen (16) monthly installments in the amount of $300.00 due on the first day of each month, commencing January 1, 2010, ending April 1, 2011;

c. A balloon payment in the amount of $319.94 due on May 1, 2011;

d. All payments shall be made by check payable to Baytherm Insulation, Inc. and delivered to Thomas S. Wroblewski, S.C., 180 Main Street, Menasha, Wisconsin 54952 on or before the due date.

2. If Defendant fails to make any payment required by Paragraph 1 above, Plaintiff shall have the right to reopen this matter, without further notice to Defendant of any kind, Defendant specifically waiving the same, and to take judgment by affidavit against the Defendant for treble the amount of damages caused by Defendant's theft by contractor, to wit: $14,268.00, plus all reasonable actual attorney fees and costs incurred by Plaintiff, less any amounts paid pursuant to Paragraph 1.

3. If Plaintiff reopens this matter and moves for judgment according to Paragraph 2 above, Defendant specifically waives any right to object to or contest Plaintiff's right to recover the amounts demanded in the Complaint, including but not limited to any such objection in the form of an answer or affirmative defense to the allegations of the Complaint, except Defendant may object to the sole issue of whether Plaintiff gave due credit to Defendant for amounts paid pursuant to paragraph 1, above.

(Stipulation and Order for Dismissal, Calumet County Circuit Court Case No. 09 CV 135, signed June 25 & 29, 2009). The stipulation was approved by the judge and the Order for Dismissal was entered on July 6, 2009.

After making one payment of $150.00 on July 1, 2009, the debtor failed to comply with the remaining terms of the stipulation and order, and a money judgment was entered upon the submission of an affidavit from plaintiff's counsel. The state court judge found Baytherm was entitled to judgment against the debtor according to the demands of the complaint and entered judgment "in the sum of $16,221.98, plus any future disbursements, costs, and attorneys' fees which may be incurred during collection of its ***395** Judgment." (Money Judgment, Calumet County Circuit Court Case No. 09 CV 135, entered September 3, 2009).

The debtor filed a chapter 13 petition on November 17, 2010, and converted to chapter 7 on July 26, 2011.

ARGUMENTS

The plaintiff urges this Court to follow its previous rulings in *In re Dinkins,* 327 B.R. 918 (Bankr.E.D.Wis.2005), and *In re Ecker,* 400 B.R. 669 (Bankr.E.D.Wis.2009), wherein no wrongful intent was deemed necessary for a finding of nondischargeability when the defendant has violated the state theft by contractor statute. Funds received by the debtor from the owners of property which the plaintiff improved constituted trust funds in the hands of the debtor and the latter was responsible for maintaining such funds in trust for the plaintiff pursuant to section 779.02(5), Wis. Stats. The debtor breached his fiduciary obligations, the state court entered a money judgment against him, and the resulting debts are nondischargeable under 11 U.S.C. § 523(a)(4).

The defendant did not file a response to the plaintiff's brief. In his answer, he denied the obligation was nondischargeable.

DISCUSSION

Summary judgment is required "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). To determine if there is a genuine issue of material fact, all facts are construed in the light most favorable to the non-moving party. *Heft v. Moore,* 351 F.3d 278, 282 (7th Cir.2003). Additionally, all reasonable inferences are drawn in favor of that party. *Id.* However, the non-movant must set forth "specific facts showing that there is a genuine issue for trial" which requires more than "just speculation or conclusory statements." *Id.* at 283 (citations omitted).

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 elements required to establish a nondischargeable debt for defalcation under this section are: (1) the existence of a trust; (2) the debtor is a fiduciary of that trust; and (3) fraud or defalcation by the debtor while acting as a fiduciary of the trust. *In re Ecker,* 400 B.R. at 671 (citations omitted). The bankruptcy

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court must look to state law to determine whether the requisite trust relationship exists. *Id.*

The "theft by contractor" provisions of sections 779.02(5) and 779.16, Wis. Stats., create a trust fund for sums paid by a property owner to a general contractor 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). Wisconsin's theft by contractor statute establishes the type of express statutory trust contemplated by section 523(a)(4) of the Bankruptcy Code. *See Matter of Thomas,* 729 F.2d 502 (7th Cir.1984) (applying Wis. Stat. § 779.16, theft by contractor statute for public improvements, which provides the same trust fund requirement for general contractors for private improvements).

Section 779.02(5) provides, in relevant part:

> Theft by Contractors. [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, ***396** services, materials, plans, and specifications used for the improvements, until all the claims have been paid.... 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).

The bankruptcy courts in Wisconsin have developed different treatments for the third element of section 523(a)(4), whether the debtor committed fraud or defalcation while acting as a fiduciary of the trust. This Court has traditionally applied a per se approach to violations of the state theft by contractor statute, without regard to any precise lack of care exercised by the debtor. *See In re Dinkins,* 327 B.R. at 923 (holding "[n]o wrongful intent is required for a finding of nondischargeability. It is only necessary for the plaintiff to prove that funds received from the owner should have been paid to a beneficiary of the statutory trust, and [that] the debtor failed to do so."); *In re Ecker,* 400 B.R. at 673 (same). Likewise, the Seventh Circuit in *Matter of Thomas,* 729 F.2d 502, 505–06 (7th Cir.1984), interpreting a similar statute relating to public works, [1] held that the general contractor satisfied its burden of establishing nondischargeability by showing the it paid the debtor subcontractors $17,894.54 to complete the work and that "the defalcation by defendants occurred when they used this trust fund for their own purposes." In that case, the defendants' "own purposes" included their home mortgages and other unrelated business debts. While it is possible that the other business debts were innocently paid, the case was remanded to determine only if any of the payments were applied to the plaintiff's project. Apparently, no other proof or evidence of wrongful conduct was necessary.

Judge Martin has disagreed with the per se approach and concluded "that something akin to 'reckless' may be the appropriate standard," and in his case, found that "more than mere negligence" was the correct standard. *In re Koch,* 197 B.R. 654, 658 (Bankr.W.D.Wis.1996) (applying standard for defalcation set by *Meyer v. Rigdon,* 36 F.3d 1375, 1382–85 (7th Cir.1994)). Judge Pepper agreed with his reasoning in *Ganther Constr., Inc. v. Ward (In re Ward),* 417 B.R. 582, 592 (Bankr.E.D.Wis.2009), and *Levine v. Ward (In re Ward),* 425 B.R. 507, 526 (Bankr.E.D.Wis.2010).

Judge Utschig was faced with the issue when the debtor argued he was merely a negligent member of the prime contractor limited liability company that failed to pay a supplier, and he exercised no control over the company's finances or checking account and was not personally involved in ***397** any misappropriation of trust funds. *In re Rieck,* 439 B.R. 698 (Bankr.W.D.Wis.2010). The court determined material facts in dispute regarding whether or not the debtor knowingly or recklessly breached his fiduciary duty, and this precluded summary judgment. Notably, the court stated, "[I]f the defendant was responsible for the company's accounts, was aware of the trust fund requirements, or was more than simply an innocent bystander 'peripherally involved' in what happened to the plaintiffs' funds, the plaintiffs may be able to demonstrate more than mere negligence on his part." *Id.* at 703. The *Rieck* court thus applied a relatively low culpability

standard while recognizing that innocent or unintentional defalcations may be discharged by a corporate officer.

Judge Kelley recently explored the degree of fault necessary to constitute defalcation in *In re Mueller,* 10–23917, 2011 WL 2360122 (Bankr.E.D.Wis. June 8, 2011). She noted that courts have progressed from earlier strict interpretations of defalcation that included innocent mistakes to more recently requiring a higher threshold of wrongful conduct. In light of the case law, Judge Kelley concluded that

> [A] creditor seeking to succeed on a claim of defalcation under section 523(a)(4) must establish something more than mere negligence: the creditor must set forth facts establishing a willful, knowing, or reckless breach of duty. Knowledge of the theft by contractor law on its own does not constitute proof of defalcation. The court should consider whether other factors exist, such as whether the debtor acted in his own self-interest or merely showed what in hindsight amounted to poor judgment.

Id. at *3.

After the debtor in this case defaulted on the parties' agreed payment schedule, the originally-stipulated award of $6,019.94 was trebled to $16,221.98, plus any future disbursements, costs, and attorney's fees which may be incurred during collection. As defined in the Bankruptcy Code, " 'debt' means liability on a claim." 11 U.S.C. § 101(12). The plaintiff's judgment unarguably is a claim in the bankruptcy case; it is a final and unappealed judgment. Since the full amount of a judgment is a valid claim, the $16,221.98 award cannot be modified, and the only issue before this Court is whether it is nondischargeable. *See In re Back Bay Restorations, Inc.,* 118 B.R. 166, 169–70 (Bankr.D.Mass.1990) (bankruptcy courts bound by prior judgments of amount of resulting damages).

It is well established that collateral estoppel or issue preclusion applies in bankruptcy proceedings. *Grogan v. Garner,* 498 U.S. 279, 285, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). As a matter of full faith and credit a federal court must apply the forum state's law of issue preclusion when it determines the preclusive effect of a state court judgment. 28 U.S.C. § 1738; *Stephan v. Rocky Mountain Chocolate Factory, Inc.,* 136 F.3d 1134, 1136 (7th Cir.1998). Additionally, the forum state's law of issue preclusion applies in determining the dischargeability of debt. *Bukowski v. Patel,* 266 B.R. 838, 842 (E.D.Wis.2001) (citing *Matter of Bulic,* 997 F.2d 299, 304 n. 6 (7th Cir.1993)). Accordingly, whether issue preclusion applies must be determined according to Wisconsin law.

Under Wisconsin law issue preclusion is a doctrine designed to limit relitigation of issues that were contested in a previous action between the same or different parties. *Mrozek v. Intra Fin. Corp.,* 2005 WI 73, ¶ 17, 281 Wis.2d 448, 699 N.W.2d 54; *Michelle T. by Sumpter v. Crozier,* 173 Wis.2d 681, 687, 495 N.W.2d 327, 329 (1993) (citing ***398** *Lawlor v. Nat'l Screen Serv. Corp.,* 349 U.S. 322, 75 S.Ct. 865, 99 L.Ed. 1122 (1955)). 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. *Landess v. Schmidt,* 115 Wis.2d 186, 197, 340 N.W.2d 213, 219 (Ct.App.1983) (citing Restatement (Second) of Judgments § 27 (1982)).

Thus, a threshold prerequisite for application of the doctrine is that, in order to be precluded from "relitigating" an issue, a party must have "actually litigated" it previously. By contrast, a determination is not conclusive "as to issues which might have been but were not litigated and determined in the prior action." *City of Sheboygan v. Nytsch,* 2006 WI App 191, ¶ 12, 296 Wis.2d 73, 722 N.W.2d 626 (citing Restatement (Second) of Judgments at § 27 cmt. e). As explained in *Nytsch:*

> An issue is not actually litigated if the defendant might have interposed it as an affirmative defense but failed to do so; nor is it actually litigated if it is raised by a material allegation of a party's pleading but is admitted (explicitly or by virtue of a failure to deny) in a responsive pleading; nor is it actually litigated if it is raised in an allegation by one party and is admitted by the other before evidence on the issue is adduced at trial; *nor is it*

> *actually litigated if it is the subject of a stipulation between the parties.*

Id. (quoting Restatement (Second) of Judgments at § 27 cmt. e; emphasis added).

Since it appears that Wisconsin courts would not treat the admission in the parties' stipulation that the plaintiff could obtain a judgment "for treble the amount of damages caused by Defendant's theft by contract" as having actually litigated the debtor's criminal intent to defraud,[2] this Court will not apply the doctrine of issue preclusion to the debtor's intent. *Cf. Klingman v. Levinson,* 831 F.2d 1292, 1296 n. 3 (7th Cir.1987) (noting "a debtor may stipulate to the underlying facts that the bankruptcy court must examine to determine whether a debt is dischargeable"). In this case, the defendant entered into a stipulation in the state case that the damages sprang from the "Defendant's theft by contractor," thus implicating the statute and its corresponding fiduciary duty and breach thereof, but it does not admit any wrongful intent, recklessness, mistake, or negligence.

The issue in this case boils down to whether damages resulting from a violation of the Wisconsin theft by contractor statute, which establishes liability for nonpayment from the statutory trust fund for any reason, is sufficient for a finding of nondischargeability under 11 U.S.C. § 523(a)(4). Under Wisconsin law, the trust fund is established by statute, and liability is established solely by nonpayment. *See Kraemer Bros.,* 138 Wis.2d at 400–02, 406 N.W.2d 379 (liability established when funds could be traced to the owner; no other standard of wrongdoing applied). If violation of the statute constitutes defalcation, issue preclusion would apply, and the matter can be decided on summary judgment. If more than mere negligence would be required to constitute ***399** defalcation, as other Wisconsin bankruptcy cases have opined, a trial is necessary to more fully develop the defendant's culpability.

For the most part, Wisconsin bankruptcy courts that have held defalcation requires more than mere negligence, relying on the standards established by the Seventh Circuit in *Meyer v. Rigdon,* 36 F.3d 1375 (7th Cir.1994). However, that case was decided under 11 U.S.C. § 523(a)(11)[3], not (a)(4). The case goes into considerable detail in the legislative history of subsection (a)(11), and Congress' intention in enacting this subsection, especially since the actions addressed would already be excepted from discharge under subsection (a)(4). The court concluded that subsection (a)(11) was narrower than (a)(4), and Congress intended to negate the application of collateral estoppel (issue preclusion) when defalcation was with respect to a depository institution, even when the matter is determined by default and not litigated. *Id.* at 1379. The court explained: "If the debt results from a final judgment arising from the debtor's fraud or 'defalcation' while acting in fiduciary capacity of a depository institution, the debt is *per se* nondischargeable in bankruptcy. No additional evidence need or may be submitted to the bankruptcy court—the debtor is estopped from challenging the nondischargeability of his debt." *Id.* at 1381–82. The court then stated that "The existence of a fiduciary relationship is a question of federal law under section 523(a)(11)" and went on to review federal banking definitions to determine that the defendant was subject to fiduciary duties. *Id.* at 1382. To determine if the former bank president debtor breached these duties, the court discussed the split among circuits as to whether something more than negligence or inadvertence would be required for nondischargeability under subsection (a)(11). The court decided that it did, *id.* at 1384–85, and then analyzed the underlying judgment to see if wrongful intent or recklessness was pled in the complaint. It was, so the court determined the debt was *per se* not subject to discharge. Faithful to the Congressional intent, the underlying default judgment was not subject to the application of issue preclusion and bankruptcy court review.

Nowhere in the opinion did the court state it was changing the developed law with respect to theft by contractor cases under 11 U.S.C. § 523(a)(4). Due to the paucity of cases under subsection (a)(11), most of the cases cited were decided under subsection (a)(4). However, the court repeatedly limited its holding to cases under (a)(11).[4] There may be a good ***400** reason to do so, since the court held issue preclusion would not apply to breaches involving depository institutions. Issue preclusion would still apply to default judgments, stipulations, and consent decrees under subsection 523(a)(4). *Id.* at 1379.

When an adversary proceeding alleging nondischargeability under 11 U.S.C. § 523(a)(4) is brought, the law regarding creation of fiduciary relationships often arises under state law, and state law would be applied to determine if there was a breach. Here, the applicable law creates a trust and states that once the owner pays for work, the "use of any such moneys by any prime contractor or subcontractor for any other purpose ... is theft by the prime contractor or subcontractor of moneys so misappropriated." Wis. Stat. § 779.02(5). Presumably, use of the words "theft" and "misapproriated" was not an

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accident of the Wisconsin legislature. Theft is synonymous with "larceny," which is also not subject to discharge under subsection 523(a)(4).[5] Wisconsin case law does not require any showing other than receipt of moneys from the owner by the prime (or superior) contractor and failure to pay over those traceable funds to the appropriate supplier of goods and services who contributed to the project. *See Kraemer Bros.,* 138 Wis.2d 395, 406 N.W.2d 379; *W.H. Major & Sons, Inc. v. Krueger,* 124 Wis.2d 284, 369 N.W.2d 400 (Ct.App.1985) In essence, wrongdoing is imputed by statute by characterizing the failure as "theft," and by referring to the funds not transmitted to the supplier as "misapproriated." The Seventh Circuit, applying an analogous Wisconsin statute that also characterized failure to pay subcontractors as "theft," remanded a case only for a determination of payments, not for a determination of knowledge or intent, as would be consistent with Wisconsin law. *See Thomas,* 729 F.2d 502. *Meyer v. Rigdon* did not establish a federal standard for defalcation for proceedings under 11 U.S.C. § 523(a)(4), nor did it reverse *Thomas* with respect to Wisconsin theft by contractor cases under subsection 523(a)(4).

Here, the underlying judgment arose under Wisconsin's theft by contractor statute, and while the stipulation did not admit intentional or wrongful conduct, Paragraph 2 admitted that the damages provided for were "caused by Defendant's theft by contractor." Consequently, the defendant has ***401** admitted violation of the statute. *See Klingman v. Levinson,* 114 F.3d at 627 (holding stipulation waived defense of issue preclusion). The provisions of the statute meet all the elements for nondischargeability under 11 U.S.C. § 523(a)(4), the damages have been determined, and the defendant's debt to the plaintiff is not subject to discharge.

The plaintiff's motion for summary judgment is granted. A separate order consistent with this opinion will be entered.

All Citations

456 B.R. 391

Footnotes

1 Wis. Stat. § 779.16, Theft by Contractors, provides, in relevant part, the following:

> All moneys, bonds or warrants paid or to become due to any prime contractor or subcontractor for public improvements are 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 performed, furnished, or procured 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.

2 Treble damages are available under section 895.446, Wis. Stat., for theft by contractor, provided the elements of both the criminal and civil statutes, sections 779.02(5) and 943.20, Wis. Stats., are proven by the civil preponderance burden of proof. *See Tri–Tech Corp. of America v. Americomp Servs., Inc.,* 2002 WI 88 ¶ 24, 254 Wis.2d 418, 646 N.W.2d 822.

3 Section 523(a)(11) provides:

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—...
>
> (11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency,

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> or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union[.]

11 U.S.C. § 523(a)(11).

4 "[M]ere negligent breach of a fiduciary duty is *not* a 'defalcation' under section 523(a)(11)." *Meyer,* 36 F.3d at 1385. "[W]e cannot say that Congress intended for a debt arising from a mere negligent breach of fiduciary duty to be excepted from discharge under section 523(a)(11)." *Id.* "Since a knowing breach of fiduciary duty is more culpable than a mere negligent breach of duty, we conclude that the FDIC's complaint does allege a 'defalcation' as that term is used in section 523(a)(11)." *Id.*

5 Black's Law Dictionary (9th ed. 2009) provides the following definition:

> theft, n. (bef. 12c) 1. The felonious taking and removing of another's personal property with the intent of depriving the true owner of it; larceny. 2. Broadly, any act or instance of stealing, including larceny, burglary, embezzlement, and false pretenses. Many modern penal codes have consolidated such property offenses under the name "theft."—Also termed (in Latin) *crimen furti.* See LARCENY. Cf. ROBBERY. "[T]he distinctions between larceny, embezzlement and false pretenses serve no useful purpose in the criminal law but are useless handicaps from the standpoint of the administration of criminal justice. One solution has been to combine all three in one section of the code under the name of 'larceny.' This has one disadvantage, however, because it frequently becomes necessary to add a modifier to make clear whether the reference is to common-law larceny or to statutory larceny. To avoid this difficulty some states have employed another word to designate a statutory offense made up of a combination of larceny, embezzlement, and false pretenses. And the word used for this purpose is 'theft.' 'Theft' is not the name of any common-law offense. At times it has been employed as a synonym of 'larceny,' but for the most part has been regarded as broader in its general scope. Under such a statute it is not necessary for the indictment charging theft to specify whether the offense is larceny, embezzlement or false pretenses." Rollin M. Perkins & Ronald N. Boyce, *Criminal Law* 389–90 (3d ed. 1982).

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669 B.R. 858
United States Bankruptcy Court, E.D. Wisconsin.

IN RE: Ger V. XIONG and Jia Xiong, Debtors.

Case No. 24-25435-gmh
|
Signed May 9, 2025

Synopsis

Background: Judgment creditors objected to Wisconsin homestead exemption claimed by Chapter 7 debtors, contending that the property was acquired with converted funds so debtors could not utilize the exemption and that the issue had already been determined in prepetition state-court fraudulent-transfer and execution-of-judgment proceedings. Debtors filed request for fees and costs, on basis that judgment creditors' objection was frivolous.

Holdings: The Bankruptcy Court, G. Michael Halfenger, Chief Judge, held that:

under Wisconsin law, state court's oral ruling in the execution-of-judgment proceedings that debtors' property was not exempt was not a "final" order to which claim or issue preclusion might apply;

under Wisconsin law, as predicted by the Court, assuming that "estoppel by record" was not a dead doctrine, estoppel by record did not apply to state court's non-final ruling on debtors' homestead exemption so as to bar debtors' claim to such exemption in their bankruptcy case;

state court's default judgment against debtors in the fraudulent-transfer action did not limit debtors' homestead exemption as a matter of claim preclusion;

state court's default judgment against debtors in the fraudulent-transfer action did not limit debtors' homestead exemption as a matter of issue preclusion; and

debtors were not entitled to an award of fees and costs.

Ordered accordingly.

Procedural Posture(s): Objection to Claimed Exemptions; Motion for Attorney's Fees; Motion for Costs.

Attorneys and Law Firms

Joseph W. Seifert, Jude Witkowski, Seifert Law Office, Milwaukee, WI, for Debtor.

OPINION AND ORDER

G. Michael Halfenger, Chief United States Bankruptcy Judge

***861** Debtors Ger and Jia Xiong filed a chapter 7 bankruptcy petition and, pursuant to 11 U.S.C. § 522(b)(3), they claimed an exemption in real property located at 353 Oak Street, Oakfield, Wisconsin, under Wisconsin's homestead exemption, ***862** Wis. Stat. § 815.20. ECF No. 1, at 18. Judgment creditors Long Lee, Miana Lee, Unlimited Wealth, LLC, David Blong, and Mee Lee (the Lee Parties) object to that exemption. ECF No. 19. The Lee Parties contend that the property was acquired with converted funds, and, as a result, the debtors cannot avail themselves of the homestead exemption because state law makes the homestead exemption inapplicable under these circumstances. ECF No. 19-1. And they assert that this court should disallow the exemption as a matter of law because the issue has already been determined in state-court proceedings.

I

To understand the Lee Parties' contention that the debtors cannot utilize the Wisconsin homestead exemption, one must begin with the parties' state-court litigation. The Lee Parties first obtained a judgment for more than $2.3 million against non-debtor Kay Yang in a circuit court case to which the debtors were not parties. To enforce that judgment the Lee Parties then sued Yang, the debtors and ten others in the Ozaukee County circuit court, requesting "judgment under Wisconsin Statutes 242.04 and 242.07" (Wisconsin's Uniform Fraudulent Transfer Act, Wis. Stat. ch. 242) to avoid allegedly fraudulent transfers made by Yang to the other defendants, including the debtors.[1] ECF No. 19-3; ECF No. 30-1, at 12. In the Ozaukee County fraudulent transfer action against the debtors, the Lee Parties alleged that to hinder their collection efforts, Yang made voidable transfers that "related to" the other defendants' purchases of property, including the debtors' real property located at 353 Oak Street, Oakfield, Wisconsin. ECF No. 30-1, at 10–11. The Ozaukee County

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circuit court entered a money judgment by default for about $2.4 million against the defendants, jointly and severally, and adjudged that several properties, including the debtors' Oak Street property, were "attached by lien in favor of the plaintiffs in the total amount of the judgment." ECF No. 19-5, at 3–4.

The Lee Parties then docketed that judgment in Fond du Lac County, the Oak Street property's situs, and initiated a second action against the debtors in that county's circuit court to execute the judgment on the property. ECF No. 19-2, at ¶6. In response, the debtors contended that the property is their homestead, thus exempt from the execution of any judgment lien up to $150 thousand, as provided in Wis. Stats. §§ 815.20 & 990.01(13) & (14).[2] ECF No. 19-8. The Lee Parties asked the Fond du Lac County circuit court to deny the debtors' exemption under Wis. Stat. § 815.18(10) and the holding in *Est. of Paulman v. Pemberton*, 246 Wis.2d 909, 633 N.W.2d 715 (Wis. Ct. App. 2001), as inapplicable to property obtained through a fraudulent transfer.[3] See ECF ***863** No. 19-7. They contended that denial of the exemption followed as a matter of course from the Ozaukee County circuit court's default judgment based on alleged fraudulent transfers. The debtors countered that the default judgment did not preclude them from maintaining for purposes of the homestead exemption that they had *not* "procured, concealed or transferred assets with the intention of defrauding creditors" and that, at a minimum, the Fond du Lac County circuit court had to determine the extent to which they acquired their residence with fraudulently transferred property, limiting the exemption's application accordingly. Wis. Stat. § 815.18(10); see also ECF No. 19-10, at 14–21; 24–27.

After considering oral argument at an October 11, 2024 hearing, the Fond du Lac County circuit court announced a ruling on the Lee Parties' request that it deny the debtors' homestead exemption. ECF No. 19-10. The court first ruled from the bench that the property was not exempt, stating:

> The Court believes that the - - that the decisions and the orders of [Ozaukee County circuit court] Judge Williams in 22-CV-162 especially applies to the defendants in this case. It applies to the property in this case. And having - - having been given opportunity to reconsider those rulings and having the - - the opportunity and the time to appeal those decisions, those - - those opinions are still in effect today. And so what this is, is the plaintiffs now attempting to execute on these judgments.
>
> And the Court will rely on those - - the decisions of the Court in Ozaukee County. I do find that - - that the Court will deny the request for the exemption and that these - - this property is not exempt from execution.
>
> I believe that the - - the Court in Ozaukee County was in the best place to decide this. I think their orders are in place. I think they stand, and the - - and merely all the plaintiffs are asking to do is execute against using those judgments, and so I'll rely on those judgments and deny the exemption.

Id. at 26–27. At the same hearing, debtors' counsel, Mr. Small, requested clarification of whether the exemption remained applicable to the extent the debtors' ownership interest did not result from the alleged fraudulent transfers. *Id.* at 27. Following a further colloquy with the debtors' counsel, the Lee Parties' counsel and counsel for the bank that holds a mortgage on the property about subsequent procedural steps, including valuing the property, listing it for sale, confirming any sale, resolving any dispute over subordination of the bank's lien, and distributing the sales proceeds, the court qualified its earlier pronouncement on the exemption, stating, "All right. As far as your request, Mr. Small, I'm not going to make a determination now. I mean, we'll make the determination. If you want to bring it up – raise the issue again in the future, you may." *Id.* at 27–31.

The Fond du Lac County circuit court never entered an order giving effect to its October 11 oral rulings. Later that day the debtors filed a bankruptcy petition initiating this case, thus staying further state-court proceedings against the debtors and their property by operation of 11 U.S.C. § 362(a). The debtors' schedule C claims their Oak Street property is exempt under Wisconsin's homestead exemption, Wis. Stat. § 815.20. ECF No. 1, at 18.

II

A

The Lee Parties first contend that, as a matter of claim or issue preclusion, the Fond du Lac County circuit court's October 11, 2024 oral ruling bars the debtors ***864** from exempting the Oak Street property under Wis. Stat. § 815.20 in this bankruptcy case. ECF No. 19-1, at 3–4 (citing *Kruckenberg v. Harvey*, 279 Wis.2d 520, 694 N.W.2d 879 (2005), and *Adair v. Sherman*, 230 F.3d 890, 893 (7th Cir. 2000)).

As this court observed in its December 13, 2024 order, claim and issue preclusion apply under Wisconsin law only when there is a final order, which the Fond du Lac County circuit court's order is not:

> Wisconsin precedent directs ... that the application of both claim preclusion and issue preclusion require entry of a final order. See *Kruckenberg v. Harvey*, [279 Wis.2d 520], 694 N.W.2d 879, 884-85 (Wis. 2005)[,] and *Jensen v. Milwaukee Mut. Ins. Co.*, [204 Wis.2d 231], 554 N.W.2d 232, 234 (Wis. App. 1996). And an order is not final for purposes of appeal unless it is in writing and filed with the clerk. See Wis. Stat. § 808.03(1)(a) (to be appealable, a final order must be "entered in accordance with ... [Wis. Stat. §] 807.11(2)", which in turn provides that "[a]n order is entered when it is filed with the office of the clerk of court.").

ECF No. 25, at 2. The Fond du Lac County circuit court's ruling would not have ended the proceedings as between the parties, the Wisconsin-law touchstone for an order being final and appealable. See *Harder v. Pfitzinger*, 274 Wis.2d 324, 682 N.W.2d 398, 402 (2004). As the transcript of the proceedings makes clear, the court's ruling only partially resolved an interlocutory request for relief: The court ruled that the debtors could not apply the homestead exemption to the extent they acquired their residence with funds wrongfully received from Yang, the Lee Parties' fraudster nemesis. The court expressly left for another day whether and to what extent the debtors could apply the homestead exemption to the extent the debtors contributed to the property's value beyond the use of any funds they received wrongfully. What is more, the court plainly did not contemplate that the ruling resolved the proceeding. At the hearing each of the parties' counsel made clear to the court that there was more to do: (i) valuation of the property; (ii) sale of the property; (iii) consideration of, and potential discovery into, whether there was a basis to subordinate the bank's mortgage; (iv) confirmation of any sale; (v) distribution of sale proceeds; and, if raised again by the debtors, (vi) a determination of whether they could apply the homestead exemption to the extent the property's value exceeded any amount received wrongfully from Yang. The circuit court's October 11 ruling did not " 'dispose[ ] of the entire matter in litigation as to one or more of the parties' ". *Wambolt v. W. Bend Mut. Ins. Co.*, 299 Wis.2d 723, 728 N.W.2d 670, 678 (2007) (emphasis omitted) (quoting Wis. Stat. § 808.03(1)). Consequently, even if the Fond du Lac County circuit court had reduced its ruling to a written order, that order would not have been final for claim and issue preclusion purposes.

This court's December 13 preliminary order observed that the Fond du Lac County circuit court's ruling appeared to be nonfinal, thus without preclusive effect, and afforded the Lee Parties an opportunity to contest that tentative conclusion. The Lee Parties did not do so, electing instead to argue other grounds to support their contention that the debtors are barred from claiming a Wisconsin homestead exemption.

B

The Lee Parties make two new arguments. They first argue that the doctrine of estoppel by record prevents the debtors ***865** from relitigating the Fond du Lac County circuit court's ruling that the debtors could not utilize Wis. Stat. § 815.20's homestead exemption. ECF No. 29, at 5–6 (citing and quoting *Lindas v. Cady*, 183 Wis.2d 547, 515 N.W.2d 458, 463 (1994), and *Brooks v. Bank of Wis. Dells*, 161 Wis.2d 39, 467 N.W.2d 187 (Wis. Ct. App. 1991)). They alternatively argue that the Ozaukee County circuit court's default judgment, as a matter of either claim or issue preclusion, bars the debtors from claiming a homestead exemption. ECF No. 29, at 6–8.

1

The Lee Parties suggest that estoppel by record can preclude subsequent adjudication of an issue even in the absence of a final order, relying on *Lindas v. Cady*'s description of what it calls "the claim preclusion-related doctrine of estoppel by record". 515 N.W.2d at 463. They read the following passage from *Lindas* to mean that, if there is an identity of parties and claims, the doctrine of estoppel by record can give preclusive effect to non-final rulings made during ongoing litigation:

> Under claim preclusion, or res judicata, "a final judgment is conclusive in all subsequent actions between the same parties as to all matters which were litigated or which might have been litigated in the former proceedings." *DePratt v. West Bend Mutual Insurance Co.*, 113 Wis.2d 306, 310, 334 N.W.2d 883 (1983). **"Estoppel by record," the doctrine relied upon by the circuit court and court of appeals in this case, is identical to claim preclusion except that it is the record of the earlier proceeding, rather than the judgment itself, which bars the subsequent proceeding.**

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> *Brooks v. Bank Of Wisconsin Dells*, 161 Wis.2d 39, 46, 467 N.W.2d 187 (Ct.App.1991). In order for claim preclusion or estoppel by record to apply, there must be an identity of parties or their privies and an identity of claims in the two cases. *DePratt*, 113 Wis.2d at 311, 334 N.W.2d 883.

Id. (emphasis added).

The preclusive effect of state court proceedings is a question of Wisconsin law to be resolved by determining (or predicting as best one can) how the Wisconsin supreme court would answer it. *Daniels v. United Healthcare Servs., Inc.*, 74 F.4th 803, 806 (7th Cir. 2023); see also 28 U.S.C. § 1738 ("The records and judicial proceedings of any court of any [ ] State [of the United States] ... shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."). No Wisconsin precedent cited by the parties or of which the court is aware definitively answers whether estoppel by record gives preclusive effect to an interlocutory ruling made in an ongoing civil action.

This court proposed at a February 4, 2025 hearing that Wisconsin law should be understood to limit the application of estoppel by record to prior proceedings that are finally adjudicated. ECF No. 34. The court suggested that *Great Lakes Trucking Co. v. Black* (among other cases) supports that understanding by equating the principles of estoppel by record and res judicata (claim preclusion). 165 Wis.2d 162, 477 N.W. 2d 65, 67–69 (Wis. Ct. App. 1991). *Great Lakes* rejected a contention that neither res judicata nor estoppel by record applied when earlier litigation was resolved by stipulation, and it can be read to treat similarly res judicata's judgment requirement and estoppel by record's adjudication requirement:

> Initially, Great Lakes argues that res judicata and estoppel by the record do ***866** not apply because there was not a prior adjudication. We disagree. **An adjudication is the giving of a judgment.** *See* BLACK'S LAW DICTIONARY 42 (6th ed. 1990). **A judgment is a final determination of the rights of the parties**.... The stipulation between Great Lakes and B & C was approved by the court and was a final determination of their rights under that action. Not only can a judgment on the merits be entered without a trial, ... but **a stipulation may act as a final judgment... Thus, there was an adjudication and a final judgment in the first proceeding**.
>
> * * * *
>
> The trial court dismissed Great Lakes' action against Black based on estoppel by the record. Estoppel by the record focuses on the former record, rather than the judgment itself, to bar the second proceeding.... The rule prevents a party from relitigating what was actually litigated—*or which might have been litigated*—in a former proceeding. [ ] Under either res judicata or estoppel by the record, there must be an identity of parties and an identity of causes of action. [ ] **Because of the analytical similarity, the cases which address res judicata equally apply to estoppel by the record**.

477 N.W.2d at 67–68 (bold added) (internal citations omitted); see also *Bankr. Est. of Lake Geneva Sugar Shack, Inc. v. Gen. Star Indem. Co.*, No. 91-C-0163, 2000 WL 1048789, at *3 (E.D. Wis. July 26, 2000) (Under Wisconsin law, "[e]stoppel by record is identical to claim preclusion except that it is the record of the earlier proceeding, rather than the judgment itself, that bars the subsequent proceeding."). [4]

Wisconsin courts have consistently equated the doctrines of res judicata and estoppel by record, thus, at a minimum, implying that estoppel by record, like res judicata (claim preclusion), precludes subsequent litigation only after final adjudication. See, e.g., *Brooks*, 467 N.W.2d at 190 ("Estoppel by record differs from *res judicata* in that it is the record of the earlier proceedings, rather than the judgment itself, that bars the second proceeding."); *Acharya v. AFSCME, Council 24, WSEU, AFL-CIO, Loc. No. 1*, 146 Wis.2d 693, 432 N.W.2d 140, 142 (Wis. Ct. App. 1988) (" 'Estoppel by record' ... prevents a party from relitigating what was actually litigated—or which might have been litigated—in a former proceeding.... It is closely related to res judicata, except that it is the former record, rather than the judgment itself, that bars the second proceeding." (citing *Leimert v. McCann*, 79 Wis.2d 289, 255 N.W.2d 526, 528 (1977))); *Leimert*, 255 N.W.2d at 528–29 (footnotes omitted) ("The doctrine of estoppel by record prevents a party from litigating again what was actually litigated or might have been litigated in a former action. Closely related is the doctrine of res judicata. This latter doctrine has the effect of making a final adjudication conclusive in a subsequent action between the same parties, or their privies, not only as to all matters which were litigated, but also as to all matters which might have been litigated in the former proceedings."); ***867** *Kuchenreuther v. Chi., M., St. P. & P.R. Co.*, 225 Wis. 613, 275 N.W. 457, 457–48 (1937) ("The doctrine of estoppel by record prevents

a party, not only from litigating again what was actually litigated in the former case, but from litigating what might have been litigated therein."); see also *Mich. Ins. Bank v. Eldred*, 17 F. Cas. 265, 266 (C.C. E.D. Wis. 1875) (No. 9,528) (citations omitted) ("To give to a judgment the effect of an estoppel, it must appear that the matter in question was or might have been directly involved in the former action as a necessary issue, and was passed upon by the court or jury at the former trial. The point or question in controversy must have been determined and adjudicated to make the record of the former proceedings conclusive. Where an action has been dismissed or a judgment given for the defendant upon a preliminary point before reaching the merits, it is no bar to another action.").

In opposing a conclusion that estoppel by record only applies after final adjudication, the Lee Parties argue, "If a final judgment or final adjudication was an element of estoppel by record, then estoppel by record and res judicata would be the same doctrine." ECF No. 37, at 2 (citing *Leimert* 255 N.W.2d at 528, 79 Wis.2d 289). As this opinion will explain, however, while estoppel by record has a distinct origin and once served in part to import broader preclusive effect than did res judicata, subsequent developments in pleading and the scope of res judicata (claim preclusion) have left estoppel by record with no unique domain.

a

"The authority of the *res judicata* ... is derived by us from the Roman law and the Canonists." *Washington, Alexandria, & Georgetown Steam-Packet Co. v. Sickles*, 65 U.S. 333, 341, 24 How. 333, 16 L.Ed. 650 (1860). Estoppel by record, on the other hand, originated under Germanic law. Robert Wyness Millar, *The Historical Relation of Estoppel by Record to Res Judicata*, 35 Ill. L. Rev. 41, 45 (1940-1941); see also Alexandra Bursak, *Preclusions*, 91 N.Y.U. L. Rev. 1651, 1660, 1664 (2016) ("[O]ur modern claim and issue preclusion derive from two separate legal traditions—res judicata, from the Roman preclusion law of the same name, and collateral estoppel, from the Anglo-Norman principle that became estoppel by the record.... Avant la lettre, a Germanic doctrine very like estoppel by record also bound parties to the claims they made and the actions they took anterior to judgment." (quotations omitted)).

Before the nineteenth century, British and American courts ruled that the res judicata effect of a prior judgment precluded subsequent efforts to plead identical claims—as narrowly construed under code pleading's requirement that a complaint "[m]atch[ ] facts to legal elements", *Thomas v. JBS Green Bay, Inc.*, 120 F.4th 1335, 1337 (7th Cir. 2024)—whereas estoppel by record barred parties from later litigating distinct claims when granting relief would contradict matters established in an earlier proceeding:

> Where the second suit is clearly no more than a repetition, at least in substance, of the former controversy (and on occasion, at least, even though the party-roles are reversed) it is the judgment itself in that first suit that stands as a barrier to the prosecution of the second. But where the second suit is not merely a repetition of the former controversy, yet is so related that to allow a given allegation therein would be to permit a contradiction of some allegation, admission or finding in the first suit, it is not the judgment itself in the first suit but the particular record term which would be thus contradicted that stands as the ***868** barrier: this and this only is the case of estoppel by record.

Millar, 35 Ill. L. Rev. at 46. "[E]stoppel by record", moreover, "was a creature of the common law; it had no place outside the common-law courts." *Id*. at 56. After the merger of law and equity and the disappearance of code-pleading rules, estoppel doctrines, like estoppel by record, were absorbed into principles of res judicata (claim preclusion) and collateral estoppel (issue preclusion), eliminating any distinctive role for "estoppel by record":

> Unquestionably, the term "estoppel by record" should be laid aside altogether in the present connection. The whole field of preclusion attendant upon judicial determination should be dealt with under the head of *res judicata*. Under this head indisputably belongs, as a matter of history, every aspect of such preclusion saving only that

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> falling within the ambit of common-law estoppel. The ghost of the latter may still occasionally walk, evoked by the citation of the old cases, but it would be difficult to maintain that it preserves today its corporeal identity. In substance it has become absorbed by the principle of *res judicata*.

Id. at 59; see also *Developments in the Law Res Judicata*, 65 Harv. L. Rev. 818, 821 (1951–1952) ("Despite their interrelationship, the Roman and Germanic doctrines were long kept distinct in judicial and academic discussion, and much confusion in terminology resulted. It was not until pleading differences and the requirement that 'record' proof establish the estoppel were abolished that they came to be recognized as parts of a single procedural doctrine."); *Miller Bldg. Corp. v. NBBJ N. Carolina, Inc.*, 129 N.C.App. 97, 497 S.E.2d 433, 435 (1998) (" 'Estoppel by record' is an antiquated phrase formerly broadly used to refer to the principles presently encompassed within the phrases res judicata (claim preclusion) and collateral estoppel (issue preclusion)."); *id.* at n.1 ("The continued use of the phrase 'estoppel by record' is discouraged. The party seeking dismissal should specify whether he seeks dismissal on the basis of res judicata or collateral estoppel.").

What is more, estoppel by record has long required final adjudication of the proceeding claimed to be preclusive: "modern courts require that issues must have been essential to a valid and final judgment before assigning them preclusive effect, [even though] this prerequisite did not attach to earlier estoppels". Bursak, 91 N.Y.U. L. Rev. at 1664. "Although the judgment could not be the source of the estoppel, final judgment was required to make the 'estoppel by record' conclusive". *Developments in the Law Res Judicata*, 65 Harv. L. Rev. at 820–21.

b

Similarly, many Wisconsin courts have described estoppel by record as being "[c]losely related" to res judicata, which, as discussed above, is only applicable following a final judgment. *Leimert*, 255 N.W.2d at 528–29. *Lindas*, an opinion of the Wisconsin supreme court, states that estoppel by record "is identical to claim preclusion except that it is the record of the earlier proceeding, rather than the judgment itself, which bars the subsequent proceeding." 515 N.W.2d at 463. *Lindas*'s description of the estoppel-by-record doctrine implies that the doctrine is applicable only following a final resolution, since, in the absence of that requirement, the doctrine would not be "identical to claim preclusion"—a doctrine that only applies after entry of final judgment. [5] In fact, the Wisconsin ***869** supreme court in *Gohr v. Beranek* plainly understood the doctrine to be limited, like res judicata (claim preclusion), to instances in which *there has been a final adjudication*, stating, " 'The doctrine of estoppel by record prevents a party, not only from litigating again what was actually litigated in the former case, but from litigating what might have been litigated therein.' ... 'The final adjudication is conclusive, in a subsequent action between the same parties, as to all matters which were litigated or which might have been litigated in the former proceedings.' " 266 Wis. 605, 64 N.W.2d 246, 249 (1954) (first quoting *Kuchenreuther,* 275 N.W. at 457–58, then quoting *Werner v. Riemer*, 255 Wis. 386, 39 N.W.2d 457, 465 (1949)). [6]

Wisconsin law is thus best understood to require a previous final adjudication as a condition to applying estoppel by record. Therefore, the Fond du Lac County circuit court's non-final ruling on the debtors' ***870** homestead exemption does not bar, as a matter of estoppel by record, the debtors' claim to a homestead exemption under Wisconsin law in this bankruptcy case.

2

The Lee Parties alternatively argue that the Ozaukee County circuit court's judgment precludes—either as a matter of claim or issue preclusion—the debtors from claiming a homestead exemption under Wisconsin law because that judgment "actually litigated whether a fraudulent transfer had occurred specific to the Xiongs' claimed homestead" and the Lee Parties prevailed on that issue. ECF No. 29, at 6 (emphasis omitted). They further contend, "Based on the [Ozaukee County] final judgment, the Debtors are precluded from arguing whether their homestead (the Property) was purchased or maintained with fraudulently obtained funds", and, as a result, the debtors are not entitled to claim the homestead exemption under *Estate of Paulman v. Pemberton* because "a homestead exemption does not apply to properties maintained with stolen or embezzled property, or by the wrongful appropriation of property rightly belonging to others." ECF No. 29, at 6–7 (quotations omitted).

As explained above, the Ozaukee County circuit court entered judgment in default based on the debtors' failure to answer the Lee Parties' complaint against them and ten other defendants. "For purposes of claim preclusion", under Wisconsin law: " 'The conclusiveness of a default judgment ... "is limited to the material issuable facts which are well pleaded in the declaration or complaint. The judgment does not extend to issues which were not raised in the pleadings." ' " *Menard, Inc. v. Liteway Lighting Prods.*, 282 Wis.2d 582, 698 N.W.2d 738, 747–48 (2005) (quoting *A.B.C.G. Enters., Inc. v. First Bank, S.E., N.A.*, 184 Wis.2d 465, 515 N.W.2d 904, 910 (1994)); see also *Nat'l Operating, L.P. v. Mut. Life Ins. Co. of N.Y.*, 244 Wis.2d 839, 630 N.W.2d 116, 131 (2001) (The claim-preclusive effect of default judgments "is limited to that which is demanded in the plaintiff's complaint." (quoting *Klaus v. Vander Heyden*, 106 Wis.2d 353, 316 N.W.2d 664, 668 (1982))). The Lee Parties' contention that the Ozaukee County default judgment bars the debtors' homestead exemption, either under Wis. Stat. § 815.18(10) or based on the homestead-exemption limitation recognized in *Estate of Paulman*, is not supported by the well-pleaded facts and issues in the Ozaukee County complaint.

a

The Ozaukee County complaint pleads that the Lee Parties previously obtained money judgments against Yang for "various statutory violations, and a failure to pay restitution". ECF No. 30-1, at 8–10. The complaint generally asserts that Yang, to avoid the Lee Parties' collection efforts, transferred unspecified assets to the "defendants" (without differentiation) "for the purchase of real property" and that the transfers were made either without receiving equivalent value or with the "intent to hinder, delay or defraud" the Lee Parties, alleging all this to be the Lee Parties' *beliefs*:

- The Lee Parties "have a good faith basis to believe that Ms. Yang transferred ... cash or other assets belonging to the [Lee Parties] to Defendants for the purchase of real property, to avoid the collection of a judgment against Ms. Yang." *Id.* at 10.
- "Plaintiffs believe that these transfers were done without receiving equivalent value." *Id.*
- ***871** "Plaintiffs believe that these transfers were done with an intent to hinder, delay or defraud the Plaintiffs' efforts to collect a present or future judgment against Ms. Yang." *Id.*
- "Plaintiffs believe each of the above transfers to be a violation of Wisconsin Statutes Chapter 242." *Id.* at 11.

As for specific allegations about debtors Ger and Jia Xiong, the complaint states only:

- "Ger Xiong was the finance director for hedge funds operated by Kay Yang, and may be an insider under Wisconsin Statutes section 242.01(7). Jia Xiong is his spouse. Their personal residence is 353 Oak St., Oakfield, WI 53065." *Id.* at 8.
- "The specific transfers related to the purchase of the following properties with the help or assistance of the persons listed: ... To Ger Xiong and Jia Xiong for the purchase of 353 Oak St., Oakfield, Wisconsin 53065." *Id.* at 10–11.

The complaint concludes by invoking the Uniform Fraudulent Transfer Act's remedy provision, Wis. Stat. § 242.07, to request that the court avoid the transactions, enjoin further transfers of the alleged properties, and "for the issuance of a writ of attachment" against those properties. *Id.* at 11–12. The complaint does not allege (even a belief) that the debtors (or any of the other defendants)—rather than Yang unilaterally—acted with an intent to defraud the Lee Parties or were aware that Yang's alleged transfers offended Wisconsin's Uniform Fraudulent Transfer Act.

The Ozaukee County circuit court's default judgment, as amended, makes the defendants, including the debtors, jointly and severally liable for more than $2.4 million, apparently the total amount of the Lee Parties' several judgments against Yang, plus the costs of the Ozaukee action. ECF No. 19-5. The amended judgment further states "that each of the following properties", including the debtors' property in Fond du Lac County, a property in Minnesota, and one in Michigan, "are attached by lien[s] in favor of the plaintiffs in the total amount of the judgment". *Id.* at 3–4.

i

The Ozaukee County circuit court's default judgment plainly does not limit as a matter of claim preclusion the debtors' exemptions under Wis. Stat. § 815.18(10). That provision expressly authorizes "the court having jurisdiction"—here, this bankruptcy court—to exercise "discretion" to deny a debtor's exemptions, if "the debtor procured, concealed or

transferred assets with the intention of defrauding creditors." *Id.* As against the debtors, the complaint contains no well-pleaded allegation that they procured their residence or otherwise acted with the *intention* of defrauding creditors (either theirs, the apparent relevant creditors for § 815.18(10), or anyone else's, including Yang's). Instead, the complaint pleads no more than that the debtors received unspecified "transfers" from Yang "related to the purchase of" their residence. ECF No. 30-1, at 10–11.

The complaint, moreover, does not plead facts that plausibly show the debtors committed actual fraud to obtain funds used to acquire their residence. The complaint's allegations are exceedingly vague and conclusory, alleging, for example, that "Plaintiffs have *a good faith basis to believe* that Ms. Yang transferred ... *cash or other assets* belonging to the Plaintiffs to Defendants for the purchase of real property, to avoid collection of a judgment against Ms. Yang." ECF No. 30-1, at 10 (emphasis added). Even aside from the ***872** fact that the allegation is limited to plaintiffs' "good faith basis to believe", no alleged facts plausibly show that Yang possessed and transferred assets *belonging to the plaintiffs* to the debtors (or to any of the defendants); as best one can tell from the complaint, the Lee Parties sought to plead that before they could collect their judgments from Yang, she transferred *her* assets to the defendants to thwart those collection efforts. The allegations of Yang's wrongdoing are not well pleaded, and they flunk by a wide margin the heightened pleading standard required to survive a motion to dismiss for a claim to void a transfer made with the actual intent to hinder or defraud creditors. See *Miller Compressing Co. v. John E. Busby and George A. Dionisopoulos, as Tr. of SFM Marital Tr.*, No. 2023AP1379, 2025 WL 1012851, at *12 (Wis. Ct. App. Apr. 1, 2025) ("We conclude that claims under WIS. STAT. § 242.04(1)(a) based on 'actual intent to ... defraud any creditor of the debtor' are required to be pleaded with particularity under WIS. STAT. § 802.03(2)."). At most, those allegations suggest only that the Lee Parties obtained money judgments against Yang, and Yang, to hinder *her* creditors, transferred assets to the various defendants, including the debtors. Those allegations, even if well pleaded, do not establish by preclusion that the debtors procured, concealed or transferred assets to defraud creditors within the meaning of Wis. Stat. § 815.18(10)'s limitation on the homestead exemption.

ii

As for the limitation on Wisconsin's statutory homestead exemption recognized in *Estate of Paulman*, that limitation is premised on the notion that when a debtor obtains a residence with converted funds, the homestead exemption does not shield it from execution by the very party whose funds the debtor converted. See *Paulman*, 633 N.W.2d at 716 & 720 (Defendant "purchased his [residence] with converted funds" based on his having "misrepresented and misused [his] apparent fiduciary authority to convert and distribute [plaintiff's] assets and monies to [his] own benefit."); see also *Warsco v. Oshkosh Sav. & Tr. Co.*, 190 Wis. 87, 208 N.W. 886, 889 (1926) ("On the trial of the action, both [defendant] and his wife unqualifiedly admitted that the sum of $2,000 received from the [plaintiff] trust company had been invested in the homestead."). As explained above, the Ozaukee County complaint makes no well-pleaded allegation that the *debtors* intentionally converted *any* funds, let alone pleading any facts that plausibly suggest that the *debtors* stole, embezzled, or converted the *Lee Parties'* funds and used those funds to purchase their residence. Therefore, *Estate of Paulman*'s limitation on the homestead exemption is not applicable here as a matter of claim preclusion.

iii

Beyond all of this, the Ozaukee County complaint does not request any *relief* related to the debtors' homestead exemption. Indeed, the homestead-exemption issue could not arise until the Lee Parties obtained a judgment to enforce against the debtors—that is, until the Ozaukee County circuit court entered its default judgment. Chapter 815, Wis. Stats., governs executions of judgment. It provides that "[a] judgment which requires the payment of money or delivery of property may be enforced in those respects by execution" and an "execution may issue at any time within 5 years after the rendition of the judgment." Wis. Stat. §§ 815.02 & 815.04. Wisconsin's homestead exemption provides that "[a]n exempt homestead" is "exempt from execution, from the lien of ***873** every judgment, and from liability for the debts of the owner to the amount of $75,000" with certain exceptions not relevant here, and it allows "[a]ny owner of an exempt homestead *against whom a judgment has been rendered and entered* in the judgment and lien docket, ..., [to] proceed under s. 806.04 for declaratory relief if the homestead is less than $75,000 in value and the owner of the judgment shall fail, for 10 days after demand, to execute a recordable release of the homestead from the judgment owner's judgment lien." Wis. Stat. § 815.20(1) & (2) (emphasis added). These chapter

815 provisions plainly contemplate that any adjudication of a homestead exemption's applicability will occur *after* rendition of the judgment that is being executed against the debtor's homestead.

As discussed above, the claim-preclusive effect of a default judgment "is limited to that which is demanded in the plaintiff's complaint." *Nat'l Operating*, 630 N.W.2d at 131 (quoting *Klaus*, 316 N.W.2d at 668). The judgment's preclusive force, therefore, does not extend to the debtors' ability to claim the homestead exemption.

Consequently, the Ozaukee County circuit court default judgment does not bar the debtors' homestead exemption as a matter of claim preclusion.

b

The Lee Parties also suggest that the Ozaukee County circuit court's default judgment may bar the debtors' homestead exemption as a matter of issue preclusion. "In Wisconsin, to determine whether issue preclusion applies, a court must first assess whether 'the question of fact or law that is sought to be precluded [was] actually ... litigated in a previous action and ... necessary to the judgment.' " *In re Landis*, No. 23-25448, 668 B.R. 606, 611 (Bankr. E.D. Wis. Mar. 31, 2025) (quoting *Mrozek v. Intra Fin. Corp.*, 281 Wis.2d 448, 699 N.W.2d 54, 61 (2005)). This "actually litigated" requirement makes issue preclusion generally inapplicable to default judgments, because, when a court enters a default judgment following a failure to answer the complaint, no contested matters are adjudicated. See *Deminsky v. Arlington Plastics Mach.*, 259 Wis.2d 587, 657 N.W.2d 411, 428 (2003) ("an issue is actually litigated when an issue is 'properly raised, by the pleadings or otherwise, and is submitted for determination, and is determined.' " (quoting Restatement (Second) of Judgments § 27, cmt. d (1982))); see also *Schouten v. Jakubiak (In re Jakubiak)*, 591 B.R. 364, 373 (Bankr. E.D. Wis. 2018) ("Wisconsin generally treats issues resolved by default judgment as not having been actually litigated: 'In the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated. Therefore, [the issue-preclusion rule] does not apply with respect to any issue in a subsequent action.' " (quoting *Heggy v. Grutzner*, 156 Wis.2d 186, 456 N.W.2d 845, 849 (Wis. Ct. App. 1990))).

There are limited circumstances, however, under which Wisconsin law affords issue-preclusive effect to default judgments, principally when a party actively obstructs the court's ability to adjudicate the alleged claims or abstains from continuing the adjudication to its conclusion after initially participating. As *Heggy* observes, comment e to § 27 of the Restatement (Second) of Judgments (1980) states, " '[E]ven if [an issue] was not litigated, the party's reasons for not litigating in the prior action may be such that preclusion would be appropriate.' " 456 N.W.2d at 849; see also *Cuene v. Peterson (In re Peterson)*, 604 B.R. 751, 767–68 (Bankr. E.D. Wis. 2019), aff'd sub nom. *Peterson v. Cuene*, 623 B.R. 758 (E.D. Wis. 2021).

***874** But the Lee Parties do not make a case for affording issue-preclusive effect to the Ozaukee County circuit court's default judgment. They do not suggest that the debtors purposely evaded service of process, like the plaintiff in *Heggy*, 456 N.W.2d at 849, or participated in the previous proceeding until declining to present evidence of damages at trial, like the debtor in *Peterson*, 604 B.R. at 768. Nor do the Lee Parties contend that the debtors did anything to obstruct their prosecution of the Ozaukee County claims to their conclusion—the debtors simply failed to answer. Contrast *Kelley v. Ahern*, 541 B.R. 860, 863 (W.D. Wis. 2015) (Giving default judgment issue-preclusive effect under Wisconsin law against party who "litigated the case for almost three years[but] did not appear at the trial."). The mere failure to answer is the paradigmatic default judgment to which issue preclusion is inapplicable.

Additionally, a default judgment does not give rise to issue preclusion over matters that were not or could not have been litigated in the prior case. *Unisys Med. Plan v. Timm*, 98 F.3d 971, 973 (7th Cir. 1996) (applying Wisconsin law); see also *Heggy*, 456 N.W.2d at 849 (issue preclusion applies to facts that are "essential to the judgment" (quotation omitted)); *Sheth v. Premierbank*, No. 15-cv-315, 2016 WL 4523937, at *11 (W.D. Wis. Aug. 22, 2016) ("[A] default judgment may be preclusive only with respect to those issues that were necessarily decided by the first court's judgment." (applying Wisconsin law and citing *Kelley*, 541 B.R. at 866, and *Heggy*, 456 N.W.2d at 849)). Again, the complaint contained no well-pleaded allegations that the debtors engaged in fraud or conversion, and its request for relief did not seek—and, for the reasons explained above, could not have sought—an adjudication of the debtors' right to the homestead exemption.[7]

Finally, the Lee Parties have not shown that the application of issue preclusion to bar the debtors' homestead exemption is "fundamentally fair," absent which issue preclusion is inapplicable. In *In re Estate of Rille ex rel. Rille*, the Wisconsin supreme court listed the following "five factors in determining whether the application of issue preclusion satisfies notions of fundamental fairness":

> 1) Could the party against whom preclusion is sought have obtained review of the judgment as a matter of law;
>
> 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; and
>
> 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?

300 Wis.2d 1, 728 N.W.2d 693, 707 (2007) (first citing ***875** *Michelle T. by Sumpter v. Crozier*, 173 Wis.2d 681, 495 N.W.2d 327, 330–31 & n.10 (1993), and then citing *Precision Erecting, Inc. v. M & I Marshall & Ilsley Bank*, 224 Wis.2d 288, 592 N.W.2d 5, 12–13 (Wis. Ct. App. 1998)). "No weight is assigned to any factor; the weighting is in the discretion of the trial court." *DeGuelle v. Camilli*, 724 F.3d 933, 937 (7th Cir. 2013) (first citing *Estate of Rille*, 728 N.W.2d at 707; and then citing *United States v. Rosales*, 716 F.3d 996, 997 (7th Cir. 2013)). [8]

> The Lee Parties contend that the fairness elements weigh in their favor, stating, as to the first element, the Debtors had an opportunity to address this issue in the Ozaukee County Case (and their subsequent appeal of that judgment). Had the Debtors not immediately filed this bankruptcy, they also could have had a review of the Fond du Lac Court's decision. Elements two through four do not apply. As for the fifth element, it is certainly not good policy to allow a Debtor to avoid the consequences of years of litigation by simply filing an electronic bankruptcy petition in order to avoid a court ruling given minutes before which rejected the Debtors' position and ruled against them.

ECF No. 29, at 7–8.

The Lee Parties do not explain what "issue" they contend the debtors had an ***876** opportunity to address in Ozaukee County. At most one might conclude that the debtors had "an opportunity to address" the well-pleaded claims against them in the Ozaukee County complaint. But, as explained above, those issues do not include actual fraud, embezzlement, or knowing conversion of the Lee Parties' property. And, whatever issues might be found in the Ozaukee County complaint, they do not include the debtors' ability to utilize the homestead exemption (in whole or in part) in response to the Lee Parties' efforts to execute on the debtors' property to satisfy the default judgment entered by the Ozaukee County circuit court after the debtors failed to answer that very same complaint.

Moreover, under the circumstances here, even if the Ozaukee County default judgment can be viewed as adjudicating issues applicable to the contested matter of the debtors' use of the Wisconsin homestead exemption, significant differences in the quality and extensiveness of the Ozaukee County proceedings and this one warrant litigating the homestead exemption issue here. The Ozaukee County complaint alleges no facts—certainly not specific ones—plausibly showing that the debtors actually defrauded the Lee Parties or converted their funds and then used those funds to acquire a residence. The complaint thus failed to put the debtors on notice that by not participating in that litigation, they risked forfeiting the homestead exemption's application as against the enforcement of any resulting judgment. Under the circumstances—taking account of both the discrete factors enumerated in the case law and considered holistically, guided by notions of justice and equity in affording appropriate weight—applying issue preclusion based on the Ozaukee County default judgment to bar the debtors' Wisconsin homestead exemption would not satisfy notions of fundamental fairness.

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As for the Fond du Lac County ruling to which the Lee Parties refer, as explained above, it is not entitled to issue-preclusive effect because it was not final. And, in all events, that court ultimately left open whether the homestead exemption might apply other than to any amount the Lee Parties show that the debtors converted and then invested into their residence.

III

One last thing. On December 9, 2024, the debtors filed an "objection to the [Lee Parties'] objection to exemption and motion for costs". ECF No. 24 (capitalization altered). The debtors request that the court award them fees and costs against the Lee Parties "for having filed a frivolous objection." *Id.* at 2. The debtors didn't support this contention with any developed argument. And they have not shown that the Lee Parties' positions were frivolous. Moreover, the debtors failed to comply with Rule 9011(c), which alone is sufficient grounds to deny their request for an award of fees and costs.

IV

For these reasons, it is hereby ordered and declared as follows:

1. The debtors' Wisconsin homestead exemption is not precluded as a matter of law by the orders, rulings, judgments, or records in the Ozaukee County or Fond du Lac County circuit courts;

2. To the extent that the Lee Parties seek to prove in this bankruptcy case that the debtors' Wisconsin homestead objection is inapplicable, either in whole or in part, that litigation will proceed in tandem with *Lee v. Xiong*, Adv. Proc. No. 24-02180, in which the Lee Parties allege that the Ozaukee County circuit court's ***877** default judgment is not dischargeable, including that all discovery and any trial will be conducted to resolve both this contested matter and the adversary proceeding; pretrial orders in the adversary proceeding govern adjudication of the contested matter.

3. The debtors' motion for an award of fees and costs is denied.

So Ordered.

All Citations

669 B.R. 858

Footnotes

1 Wisconsin's Uniform Fraudulent Transfer Act was amended on March 29, 2024, when 2023 Wisconsin Act 246 took effect. Among other changes, the Act renamed chapter 242 the "Uniform Voidable Transactions Law." 2023 Wisconsin Act 246, §§ 1–32 (eff. Mar. 29, 2024).

2 In their bankruptcy schedules, the debtors value the property at $245 thousand subject to a mortgage that secures a claim held by Bank First for about $155 thousand. ECF No. 1, at 22.

3 See Wis. Stat. §§ 815.18(10) ("Any or all of the exemptions granted by this section may be denied if, in the discretion of the court having jurisdiction, the debtor procured, concealed or transferred assets with the intention of defrauding creditors.") & 815.18(13)(d) (making sub. (10) applicable to a homestead exemption under Wis. Stat. § 815.20); see also *Est. of Paulman*, 633 N.W.2d 715 (holding that Wis. Stat. § 815.20 does not apply to the extent a homestead is acquired with converted funds).

4 One unreported opinion of the Wisconsin court of appeals from 1981 (which Wis. Stat. § 809.23(3)(a) deprives of even persuasive value in Wisconsin courts) expressly equates estoppel by record and res judicata: "Res judicata precludes a party from asserting a cause of action after there has been a final judgment on the merits of the same cause of action between the same parties. This is claim preclusion or merger and bar. **It is also known as estoppel by record** and applies to issues that were litigated or might have been litigated."

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Robinson v. Oneida Cnty., No. 81-441, 1981 WL 139030, *1 (Wis. Ct. App. Nov. 3, 1981) (unreported) (emphasis added) (footnotes omitted).

5 Even decisions addressing estoppel by record in the administrative law context contemplate a final determination on the merits. See *Acharya*, 432 N.W.2d at 142 ("[T]he commission resolved both issues against Acharya, and its decision was upheld in judicial review proceedings in circuit court."); *Lindas v Cady*, 175 Wis.2d 270, 499 N.W.2d 692, 697 (Wis. Ct. App. 1993) ("We could have been more precise in our final sentence of *Acharya*. But the entire opinion considers the preclusive effect of an unreviewed administrative decision. We had no need to consider the preclusive effect of reviewed administrative decisions, for that issue was not before us."); Colleen D. Ball, *Bound and Determined: The Preclusive Effect of Agency Decisions*, 69 Wis. Law. 20, 21, 61 (Aug. 1996) ("The doctrine of estoppel by record is closely related to the concept of claim preclusion.... When a party to an administrative proceeding receives the same procedural protections afforded a courtroom trial, preclusion principles provide a useful means of limiting vexatious lawsuits, conserving judicial resources and preventing inconsistent decisions.").

6 The Wisconsin court of appeals has at times equated estoppel by record with collateral estoppel (issue preclusion). See, e.g., *Portage Cnty. Bank v. Deist*, 159 Wis.2d 793, 464 N.W.2d 856, 859 (Wis. Ct. App. 1990) (citations omitted) ("They use the term 'estoppel by record,' a usage consistent with some older cases, ... This rule, known as 'issue preclusion,' subsumes the concepts of direct and collateral estoppel, ... and is included in the concept 'res judicata.' "); *Meyer v. Dept. of Transp.*, 1994 WL 679080, *2 n.1 (Wis. Ct. App. 1994) (unpublished) ("Collateral estoppel, also known as estoppel by the record or issue preclusion, is intended to limit the relitigation of issues that have already been litigated in a previous action."); *State ex rel. Bennett v. Sobczak*, 1981 WL 138702, *3 n.5 (Wis. Ct. App. 1981) (unpublished) (citations omitted) ("The doctrine of collateral estoppel, or estoppel by record, operates to prevent relitigation of an issue that actually was litigated in a former action.... This doctrine, also called issue preclusion, is appropriately invoked where the party against whom it is asserted had the opportunity to fully and fairly litigate the issue in a prior action."); *Schaefer v. Schaefer*, 1979 WL 30708, *2 (Wis. Ct. App. 1979) (unpublished) ("Instead, the similar doctrine of collateral estoppel or estoppel by record is appropriate. The doctrine of estoppel by record prevents a party from litigating again what was actually litigated or what might have been litigated in a former action.").

These statements equating "estoppel by record" and issue preclusion (collateral estoppel) cannot be readily reconciled with the Wisconsin supreme court's pronouncements on estoppel by record that are discussed above. Of these, however, only the court of appeals' decision in *Portage County Bank v. Deist* is precedential. See Wis. Stat. § 809.23(3)(a). And, again, this court's task in applying Wisconsin law is to predict how the Wisconsin supreme court would resolve the issue. *Daniels*, 74 F.4th at 806. For the reasons explained above, the best prediction is that the Wisconsin supreme court would, consistent with its precedents, apply estoppel by record only following entry of a final order, presuming that the court would not instead declare estoppel by record a dead doctrine, fully overtaken by modern claim-preclusion law. See Millar, 35 Ill. L. Rev. at 59. In all events, even if *Portage County Bank v. Deist* were correct in equating estoppel by record with issue preclusion, that does not aid the Lee Parties, because issue preclusion also requires a final order. See *Jensen*, 554 N.W.2d at 235.

7 The Lee Parties rhetorically contend, "If the Debtors wanted to assert that a fraudulent transfer claim was not adequately pled, that issue could have actually been litigated in Ozaukee County." ECF No. 29, at 6. Perhaps, but the fact that the debtors did not contest the adequacy of the complaint before entry of a default judgment does not enlarge the preclusive effect of that default judgment beyond the complaint's *well-pleaded* allegations and requests for relief. Wisconsin law is clear on that. *Menard*, 698 N.W.2d at 747–48.

8 As *In re Landis* explains,

DeGuelle observes several conceptual difficulties with the "five-factor 'test' " adopted by *Estate of Rille*:

> The first factor gestures, a little mysteriously, to the requirement that the loser have been able to appeal the adverse ruling sought to be used against him; the requirement is diluted in the Wisconsin supreme court's formulation by the trial judge's having discretion as to how heavily to weight it. Factor 2 we do not understand at all. Factors 3 and 4 are aspects of the requirement that the loser have had an opportunity for an adequate hearing in the first proceeding. Factor 5, while also related to the adequacy of that hearing, opens a Pandora's Box by invoking public policy, individual circumstances, and fundamental fairness. So the five-factor test is really eight factors. Would we could stop with eight! We can't; for after listing the eight factors the opinion states that "these enumerated factors are illustrative; they are not exclusive or dispositive.... The final decision whether the doctrine of issue preclusion [collateral estoppel] should be applied rests on the [trial] court's sense of justice and equity." The "test" thus is formless. (And what by the way is the difference between "justice" and "equity"?)
>
> Later in the opinion we learn that in applying factor 5 the trial court must ' ''balance competing goals of judicial efficiency and finality, protection against repetitious or harassing litigation, and the right to litigate one's claims.'' ' That brings the number of factors to 11, though in a later case we learn that "the overarching task" in applying the doctrine of collateral estoppel is "to make a holistic, discretionary determination regarding fundamental fairness." Holistic analysis is the opposite of dissecting an issue into parts.
>
> [*DeGuelle v. Camilli,*] 724 F.3d at 937–38 (citations omitted) (omission from quotation in original) (first quoting *Estate of Rille*, 728 N.W.2d at 707; then quoting *Estate of Rille*, 728 N.W.2d at 712; and then quoting *Aldrich v. Lab. & Indus. Rev. Comm'n*, 341 Wis.2d 36, 814 N.W.2d 433, 458 (2012)). Still, this court's duty is to apply Wisconsin's issue-preclusion law as best it can, so it considers *Estate of Rille*'s five non-exclusive factors, as well as other relevant considerations, guided by its sense of justice and equity, to determine whether applying issue preclusion ... would be fundamentally fair. See *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 369, 116 S.Ct. 873, 134 L.Ed.2d 6 (1996) ("Absent a partial repeal of the Full Faith and Credit Act, 28 U.S.C. § 1738, by another federal statute, a federal court must give the judgment the same effect that it would have in the courts of the State in which it was rendered.").

Landis, 668 B.R. 606, 612 n.7.

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THEFT BY CONTRACTOR

Wisconsin Solo & Small Firm Conference
Kalahari Resort and Conference Center
Wisconsin Dells
October 22, 2026

Attorney Kevin Trost
Trost LLC
Madison, WI

1. **Overview, Background, and Elements**

   Wis. Stat. § 779.16

   Wis. Stat. § 943.20 / Wis. Stat. § 895.446

2. **Real World Examples**

3. **Practical Considerations for Filing Civil Claims of Theft by Contractor**

4. **How Clients Can Minimize the Risk of Becoming a Victim of Theft by Contractor**

2722 THEFT BY CONTRACTOR (Wis. Stat. § 779.02(5); § 779.16)[1]

Theft by contractor, is committed by one who, under an agreement for the improvement of land, receives money from the owner, and who, without consent of the owner, contrary to his or her authority, intentionally uses any of the money for any purpose other than the payment of claims due or to become due from the defendant for labor or materials used in the improvements before all claims are paid [in full] [proportionally in case of a deficiency].[2]

To sustain a claim based on theft by contractor, the plaintiff must prove the following elements:

First, (defendant) entered into an oral or written agreement for the improvement of land. (Building) (Repairing) (Altering) (_____) a (house) (garage) (_____) is an improvement of land.

Second, (defendant) received money from the owner under the agreement for the improvement of land. ["Owner" means the owner of any interest in land who, personally or through an agent, enters into a contract for the improvement of the land.[3]]

Third, (Defendant) [intentionally][4] (used) (retained) (concealed) part or all of the money for a purpose other than the payment of claims due or to become due from (defendant) for labor or materials used in the improvements before all claims were paid [in full] [proportionally in case of a deficiency].[5] [In deciding whether this element has been proved, you may consider whether the claim was subject to a bona fide dispute. A "bona

fide" claim arises from a dispute that is real, actual, genuine, and in fact exists and is not merely pretextual or feigned on the part of the party in an attempt to avoid his or her obligations under the law.][6]

[You cannot look into a person's mind to find intent. Intent must be found, if found at all, from the defendant's acts, words, and statements, if any, and from all the facts and circumstances in this case bearing upon intent.][7]

Fourth, the use of the money was without the consent of the owner of the land and contrary to (defendant)'s authority.

Fifth, (plaintiff) suffered a monetary loss as a result of (defendant)'s use of the money.

It is your duty to find whether the plaintiff has proven the elements by a preponderance of the credible evidence.[8]

[Burden of Proof: Ordinary, see Wis JI-Civil 200]

[Note: In cases where exemplary damages are requested, the trial judge serves as gatekeeper and must determine whether the issue goes to the jury.]

[If you find that questions concerning exemplary damages are appropriate, add the following:

Exemplary damages are an issue in this case. Exemplary damages may be awarded, in addition to compensatory damages, if you find that the defendant committed theft by contractor. The purpose of exemplary damages is to punish a wrongdoer or deter the wrongdoer and others from engaging in similar conduct in the future. Exemplary damages

are not awarded to compensate the plaintiff for any loss he or she has sustained. A plaintiff is not entitled to exemplary damages as a matter of right. Even if you find that the defendant committed theft by contractor, you do not have to award exemplary damages. Exemplary damages may be awarded or withheld at your discretion under these instructions and the evidence in this case. You may not, however, award exemplary damages unless you have awarded compensatory damages.[9]

(Plaintiff) must satisfy you by a preponderance of the credible evidence that exemplary damages should be awarded. If you believe that you should assess exemplary damages against (defendant) by way of punishment and as a warning to others, then you should award such damages as you deem just and proper. Otherwise, you will insert the word "zero" in answer to question eight.[10]]

VERDICT

Question No. 1: Did (Defendant) enter into an agreement for the improvement of land?

ANSWER: _____

(Yes/No)

Question No. 2: If you answered "yes" to Question 1, then answer this question:

Did (Defendant) receive money from the owner under an agreement for the improvement of land?

ANSWER: _____

(Yes/No)

Question No. 3: If you answered "yes" to Question 2, then answer this question:

Did (Defendant) [intentionally] (use) (retain) (conceal) part or all of the money for a purpose other than the payment of claims due or to become due from (Defendant) for labor or materials used in the improvements before all claims were paid [in full] [proportionally in case of a deficiency]?

ANSWER: _____

(Yes/No)

Question No. 4: If you answered "yes" to Question 3, then answer this question:

Was (Defendant)'s use of the money without the consent of the owner of the land and contrary to the (Defendant)'s authority?

ANSWER: _____

(Yes/No)

Question No. 5: If you answered "yes" to Question 4, then answer this question:

Did (Plaintiff) suffer a monetary loss as a result of (Defendant)'s use of the money?[11]

ANSWER: _____

(Yes/No)

Question No. 6: If you answered "yes" to Question 5, then answer this question:

What is the amount of the monetary loss suffered by (Plaintiff) as result of (Defendant)'s use of the money?

ANSWER: $_____

[IF THE PLAINTIFF REQUESTS EXEMPLARY DAMAGES UNDER §895.446, ADD THE FOLLOWING QUESTIONS:

Question No. 7: If you answered "yes" to Question 4, then answer this question:

Did (Defendant) know that the use of the money was without the consent of the owner of the land and contrary to the (Defendant)'s authority?

ANSWER: _____

(Yes/No)[12]

Question No. 8: If you answered "yes" to Question 7, then answer this question:

What sum of money, if any, do you assess against (Defendant) as exemplary damages for theft by contractor?

$ _____]

NOTES

1. The jury instruction for a criminal violation of Wis. Stat. § 779.02(5) and § 779.16 is WIS JI-CRIMINAL 1443. Although §779.02(5) applies to private construction projects and § 779.16 applies to public improvement projects, this instruction is applicable to both situations. Where relevant, this instruction follows and is consistent with WIS JI-CRIMINAL 1443. As discussed more fully in Note 6, there may be cases in which a civil recovery is warranted without the criminal intent necessary to support a criminal conviction.

2. § 779.02(5) prohibits a contractor's use of moneys paid for purposes other than the payment of claims until the claims have been paid in full "or proportionally in cases of a deficiency." The deficiency situation is discussed in State v. Keyes, 2008 WI 54, 309 Wis.2d 516, 750 N.W.2d 30 at ¶¶20-34. Use the language in the second set of brackets in the case of a deficiency.

3. This definition is based on the definition of "Owner" in Wis. Stat. §779.01(2)(c).

4. A showing of wrongful intent is not required to establish civil liability under §779.02(5). See Burmeister Woodwork Co. v. Friedel, 65 Wis. 2d 293, 302, 222 N.W.2d 647 (1974). However, to qualify for treble damages under Wis. Stat. § 895.80, the elements of both the civil and the criminal statutes,

including the specific criminal intent element required by § 943.20, must be proven to the civil preponderance burden of proof. See Wis. Stat. §779.02(5). See also Tri-Tech Corp. of America v. Americomp Services, Inc., 2002 WI 88, ¶30, 254 Wis. 2d 418, 646 N.W.2d 822.

5. The criminal jury instruction note on this element points out that "The third element was affirmed as a correct statement of the law in State v. Sobkowiak, 173 Wis.2d 327, 336-39, 496 N.W.2d 620 (Ct. App. 1992): 'The intent establishing the violation is the intent to use moneys subject to a trust for purposes inconsistent with the trust.' No further intent – to defraud or to permanently deprive – is required."

6. See Kansas City Star Co. v. DILHR, 60 Wis. 2d 591, 601, 211 N.W.2d 488 (1973).

7. Include the bracketed language if the claim seeks exemplary damages. See footnote 4, supra.

8. Wis. Stat. § 895.446(2) provides the following:

> The burden of proof in a civil action under sub. (1) is with the person who suffers damage or loss to prove a violation of s….943.20…by a preponderance of the credible evidence.

9. Compensatory damages must be awarded before punitive damages can be given. Widemshek v. Fale, 17 Wis.2d 337, 340, 117 N.W.2d 275 (1962); Bachand v. Connecticut Gen. Life Ins. Co., 101 Wis.2d 617, 633, 305 N.W.2d 149 (Ct. App. 1981). However, if the compensatory damages are nominal, that is - six cents, punitive damages cannot be awarded. Barnard v. Cohen, 165 Wis. 417, 162 N.W. 480 (1917); Wussow v. Commercial Mechanisms, Inc., 90 Wis.2d 136, 140, 279 N.W.2d 503 (Ct. App. 1979).

10. **Limitation on damages**. Punitive damages received by the plaintiff may not exceed twice the amount of any compensatory damages recovered by the plaintiff or $200,000, whichever is greater. See Wis. Stat. § 895.043(6).

11. If the plaintiff is proceeding on other causes of action such as breach of contract, the verdict questions on damages will have to be integrated. Because damages for theft by contractor may be eligible for actual costs and exemplary damages under §895.446, it will be necessary to differentiate such damages from damages based on other claims.

12. This verdict question addresses the element of criminal intent, which is not necessary to sustain a simple claim for civil damages under §779.02(5) or 779.16, but is necessary to sustain a claim for exemplary damages and litigation costs under §895.446. The Wisconsin Supreme Court decision in Tri-Tech v. Americomp, 254 Wis.2d 418 (2002) contemplates the possibility of a civil claim based on a violation of Wis. Stat. §779.02(5) which would not qualify for treble damages if the violation was not the result of the requisite criminal intent:

> Because Wis. Stat. §943.20 is one of the offenses that qualifies for the treble damages remedy of Wis. Stat. §895.80 [now renumbered to §895.446], we agree with the court of appeals' conclusion that treble damages are available for theft by contractor under Wis. Stat. § 779.02(5), provided, however, that the elements of both the civil and the criminal statutes are proven, albeit to the civil preponderance burden of proof. Stated differently, the basis of liability for criminal theft by contractor is a violation of the trust fund provisions of Wis. Stat. §779.02(5), plus the criminal intent required by Wis. Stat. § 943.20(1)(b). 254 Wis.2d at 430.

What exactly is it the plaintiff must prove to demonstrate criminal intent? The court in Tri-Tech explained the requirement as follows:

> Accordingly, to sustain a cause of action for treble damages under Wis. Stat. § 895.446 for theft by contractor under Wis. Stat. § 943.20, the plaintiff must prove, by a preponderance of the credible evidence, the elements of the criminal offense, including that the defendant knowingly retained, concealed, or used contractor trust funds without the owner's consent, contrary to his authority, and with intent to convert such funds to his own use or the use of another. Id. at 433.

The Criminal Jury Instructions Committee discusses the required level of intent in its footnote 8 to WIS JI-CRIMINAL 1443:

> In State v. Hess, 99 Wis.2d 22, 298 N.W.2d 111 (Ct. App. 1980), the court held that theft by contractors requires only "criminal intent" and not "intent to defraud." Hess seems to indicate the "criminal intent" boils down to knowledge that the defendant is in the position of trustee and that he intentionally uses the money for some other purpose than paying the suppliers. Wis JI-Criminal 1443 is drafted on the premise that using the funds for any purpose other than paying off the lien claimants is theft by contractor. This position is consistent with Hess, and with other recent cases: State v. Blaisell, 85 Wis.2d 172, 270 N.W.2d 69 (1978); State v. Wolter, 85 Wis.2d 353, 270 N.W.2d 230 (Ct. App. 1978).
>
> The 1976 version of Wis JI-Criminal 1443 included a sixth element which emphasized that the defendant must act with intent to convert the funds to his own personal use. This element has been eliminated as possibly confusing in light of the Hess, Blaisell, and Wolter decisions discussed above. The matter is not as clear as one would like, since Hess and Wolter both cite the 1976 version of Wis JI-Criminal 1443 with approval while reaching conclusions that are arguably inconsistent with the instruction's emphasis on "personal use." The Committee takes the position that using the trust fund money for any purpose other than paying off the lienholders is "personal use" and thus the sixth element in the 1976 instruction was redundant.
>
> This note was cited with apparent approval in State v. Sobkowiak, . . .
>
> In Tri-Tech Corp. v. Americomp Services, 2002 WI 88, 254 Wis.2d 418, 646 N.W.2d 822 – a civil case – the court referred to the "six elements" of theft by contractor without referring to this instruction or to State v. Sobkowiak, . . . The Committee concluded that this reference did not require a change in the conclusion that the offense can be defined with five elements as described above.

As a result of the holding in Tri-Tech, the Civil Jury Instructions Committee believes that the intent described in WIS JI-Criminal 1443 is what is necessary to sustain a civil claim for treble damages. This position was seemingly affirmed in Century Fence Company v. American Sewer Services, Inc., 2021 WI App 75, 399 Wis.2d 742, ¶9, 967 N.W.2d 32. In Century, the court of appeals cited Tri-Tech's conclusion that "…the elements of Wis. Stat. §§ 779.02(6) and 943.20 must be proven" in order to sustain the plaintiff's cause of action for treble damages.

Century also clarified that with regard to element three, absent evidence of a demand and refusal to pay, a defendant's admission to depositing payment into an account encumbered by a security interest "is

insufficient by itself to establish a prima facie case of specific criminal intent." Century, supra, at ¶11 citing Tri-Tech, 254 Wis. 2d 418, ¶32.

Verdict Question No. 7 mirrors the fifth and final element of Wis JI-Criminal 1443**.**

COMMENT

This instruction was approved in 2015. This revision was approved by the Committee in October 2022; it clarified the required burden of proof and added to the comment. See also Wis JI-Criminal 1443.

2420 CIVIL THEFT: WIS. STAT. § 895.446 (Based on Conduct (Theft) Prohibited by Wis. Stat. §943.20(1)(a))

Theft is committed by one who intentionally (takes and carries away) (uses) (transfers) (conceals) (retains possession of)[1] movable property of another without consent and with intent to deprive the owner permanently of possession of the property. In order to recover for a civil theft, (plaintiff) must prove by evidence that satisfies you to a reasonable certainty by the greater weight of the credible evidence that the following four elements were present:

First, that defendant intentionally took and carried away movable property of another.[2]

The term "intentionally" means the defendant must have had the mental purpose to take and carry away the property.[3] You cannot look into a person's mind to find intent and knowledge. Intent and knowledge must be found, if found at all, from the defendant's acts, words, and statements, if any, and from all the facts and circumstances in this case bearing upon intent and knowledge.

"Movable property" means property whose physical location can be changed.[4]

Second, that the owner of the property did not consent[5] to the taking and carrying away the property.

Third, that the defendant knew that the owner did not consent.[6]

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Fourth, that the defendant intended to deprive the owner permanently of the possession of the property.

[Burden of Proof: Give Wis JI-Civil 200.]

COMMENT

This instruction and comment were approved by the Committee in 2018.

The instruction is based on a claim of theft in violation of Wis. Stat. § 943.20. Other types of criminal conduct, such as retail theft, worthless checks, fraud on an innkeeper, and theft by contractor (see Tri-Tech Corp. v. Americomp Serv., 2002 WI 88, 254 Wis.2d 418, 646 N.W.2d 822), also serve as a possible basis for a claim under Wis. Stat. § 895.446. If one of these other grounds of liability is claimed, this instruction must be adapted to the elements of the particular criminal statute.

The burden of proof is the ordinary burden See Wis. Stat. § 895.446(2)

Damages. In Estate of Miller v. Storey, 2017 WI 99 (Nov. 30 2017), the Wisconsin Supreme Court held that civil theft actions, under Wis. Stat. section 895.446, are not actions based in tort – ruling that the estate could obtain a $10,000 actual damage award. The majority also ruled that double costs were authorized and that the estate could obtain attorney fees as "costs of investigation and litigation" under § 895.466(3)(b). However, a majority ruled that the appeals court did not commit an error in reversing the circuit court's award of $20,000 in exemplary damages.

1. One of the five alternatives in parenthesis should be selected. The rest of the instruction is drafted for a case where the act is alleged to be "takes and carries away," which, in the Committee's judgment, is the most commonly charged alternative.

In State v. Genova, 77 Wis,2d 141, 252 N.W.2d 380 (1977), the Wisconsin Supreme Court approved the construction of the theft statute adopted in Wis JI-Criminal 1441. A theft charge had been dismissed on the basis that the complaint charged only that the defendant had transferred property and no that he had taken the property and transferred it. The Wisconsin Supreme Court held that the complaint had been sufficient in charging only "transfer." The statute should be read as though the following "ors" appeared in it: takes and carries away, or transfers, or conceals, or retains. A violation of the statute need not include a taking from the owner.

2. Define "movable property of another" if necessary. The term is defined as follows in §§ 939.22(28) and 943.20(2)(c):

> 939.22(28) "Property of another" means property in which a person other than the actor has a legal interest which the actor has no right to defeat or impair, even though the actor may also have a legal interest in the property.
>
> 943.20(2)(c): "Property of another" includes property in which the actor is a co-owner and property of a partnership of which the actor is a member, unless the actor and the victim are husband and wife.

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3. "Intentionally" also is satisfied if the person "is aware that his or her conduct is practically certain to cause [the] result." In the context of this offense, it is unlikely that the "practically certain" alternative will apply so it has been left out of the text of this instruction. See Wis JI-Criminal 923B for an instruction that includes that alternative.

4. This is based on the definition of "movable property" in §943.20(2)(a) which provides:

> (a) "Movable property" is property whose physical location can be changed, without limitation including electricity and gas, documents which represent or embody intangible rights, and things growing on, affixed to or found in land.
>
> Section 943.20(2) defines "property" as follows:
>
> (b) "Property" means all forms of tangible property, whether real or personal, without limitation including electricity and gas, documents which represent or embody a chose in action or other intangible rights.

5. If the definition of "without consent" is believed to be necessary, see Wis JI-Criminal 948 which provides and instruction based on the definition provided in § 939.22(48). That definition provides that "without consent" means "no consent in fact" or that consent was given because of fear, a claim of legal authority by the defendant, or misunderstanding.

6. Knowledge that the taking was without consent is required because the definition of this offense begins with the word "intentionally." Section 939.23(3) provides that the word "intentionally" requires knowledge of those facts which are necessary to make [the] conduct criminal and which are set forth after the word "intentionally" in the statute.

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Century Fence Co. v. Am. Sewer Servs.

Court of Appeals of Wisconsin, District Two

October 6, 2021, Decided; October 6, 2021, Filed

Appeal No. 2019AP2432

Reporter
399 Wis. 2d 742 *; 967 N.W.2d 32 **; 2021 Wisc. App. LEXIS 896 ***; 2021 WI App 75; 2021 WL 4564775

CENTURY FENCE COMPANY, PLAINTIFF-APPELLANT, v. AMERICAN SEWER SERVICES, INC. AND DENNIS BIONDICH, DEFENDANTS-RESPONDENTS.

Subsequent History: Review denied by *Century Fence Co. v. Am. Sewer Servs., 2022 Wisc. LEXIS 143 (Wis., Feb. 16, 2022)*

Prior History: [*1]** APPEAL from an order of the circuit court for Waukesha County: RALPH M. RAMIREZ, Judge. Cir. Ct. No. 2018CV578.

Disposition: Reversed and cause remanded for further proceedings.

Core Terms

theft, contractor, owed, circuit court, prime contractor, refuse to pay, trust account, subcontractor, general account, conceal, fence, own use, convert, amount due, good cause, pavement-marking, facie

Case Summary

Overview

HOLDINGS: [1]-The circuit court erred in determining that a sub-contractor failed to prove ***theft by contractor*** under *Wis. Stat. § 943.20* because the general contractor could not lawfully retain any of the funds for its own purposes until it paid the sub-contractor's claim on the contract; the general contractor retained and used the $10,245 it owed the sub-contractor for a "purpose" other than paying the sub-contractor—to support its general account for payment of its own business obligations.

Outcome
The judgment was reversed and remanded.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > Clearly Erroneous Review

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

HN1[] **Standards of Review, Clearly Erroneous Review**

Where the circuit court acts as the trier of fact, an appellate court will not upset the court's findings unless they are clearly erroneous. Wis. Stat. § 805.17(2) (2019-20). Interpretation and application of the law to those facts, however, is a matter of law the appellate court reviews de novo.

Real Property Law > Construction Law > Contractors & Subcontractors
Business & Corporate Compliance > Real Property > Construction Law > Contractors & Subcontractors

HN2[] **Construction Law, Contractors & Subcontractors**

Where funds are used for the ordinary and normal expenses of the business, they are used for purposes other than the payment of claims as provided in Wis. Stat. § 779.16 (2019-20), which is the only important point. Payments made to a prime contractor are not

actually owned by the prime contractor.

Civil Procedure > Remedies > Damages > Punitive Damages

Torts > Intentional Torts > Breach of Fiduciary Duty > Remedies

HN3[] **Damages, Punitive Damages**

Refusal with good cause to pay a disputed amount on contract cannot and should not be a tort. If the prime contractor has good cause to refuse to pay, it has not violated its fiduciary duty, no tort results and punitive damages are unavailable.

Judges: Before Gundrum, P.J., Neubauer and Reilly, JJ.

Opinion by: GUNDRUM

Opinion

[*744] [33]** P1 GUNDRUM, P.J. Century Fence Company appeals from an order of the circuit court dismissing its claim under *Wis. Stat. § 779.16* (2019-20)[1] for ***theft by contractor***. Century contends it is the victim of such theft committed by American Sewer Services, Inc. and Dennis Biondich and that following the court trial on the claim, the circuit court erroneously held to the contrary. We agree, and we reverse and remand for further proceedings.

Background

P2 American was the prime contractor for the City of Waukesha to replace a water main on Les Paul Parkway. As such, American entered into a subcontract with Century in February 2016 for Century to provide pavement-marking services for $10,995. In October **[*745]** 2016, after Century performed the services, it billed American $10,245, applying a $750 discount to the final bill. American subsequently requested payment from Waukesha of $11,000 for Century's services, and in December 2016, Waukesha paid American that amount for these services, which payment American **[***2]** deposited into its general account that same month.

P3 Despite receiving this payment from Waukesha, American did not pay Century. **[**34]** Instead, on March 1, 2017, Biondich, the president and sole shareholder of American, sent a letter to Century claiming that American owed Century only $3007—and requesting that Century revise its bill to indicate this—because when Century arrived at the job site there ended up being less work for Century to perform than what had been contemplated when American accepted Century's bid for the job.[2] In a March 9, 2017 letter to Biondich, Century responded that it was entitled to the full payment of $10,245 as the contract was a "lump sum," not "unit price," contract. Century further explained additional work it had to perform to fulfill the contract, for which it did not charge American. American still **[*746]** did not pay Century any portion of the $11,000 it had received from Waukesha for Century's services.

P4 By counsel, Century again sought full payment from American, but American did not comply; instead, in February 2018, American transferred $11,000 to the client trust account of American's own counsel. On March 27, 2018, Century filed suit against American **[***3]** and Biondich, and it subsequently filed an amended complaint stating causes of action for ***theft by contractor***, misappropriation of trust funds, unjust enrichment, breach of contract, and conversion. On February 27, 2019—eleven months after Century filed suit and nearly two and one-half years after Century performed the pavement-marking services for American pursuant to their contract—counsel for American sent a check in the amount of $3007 from the firm's client trust account made payable to the client trust account of counsel for Century.

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[1] All references to the Wisconsin Statutes are to the 2019-20 version unless otherwise noted.

[2] The circuit court found that Biondich was the one who made "[t]he decision to co-mingle the funds received from Waukesha in American Sewer's account, as well as the decision to withhold payment from Century Fence." American and Biondich do not challenge this finding on appeal; thus, the misappropriation in this case is deemed theft by Biondich as well as American. *See* *Wis. Stat. § 779.16* ("If the prime contractor or subcontractor is a corporation, limited liability company, or other legal entity other than a sole proprietorship, such misappropriation also shall be deemed theft by any officers, directors, members, partners, or agents responsible for the misappropriation."). At times we will use "American" to refer to American Sewer Services, Inc., and at times we will use it to refer to American and Biondich collectively.

P5 Century's suit came on for a court trial, and the circuit court found that it was "very clear" that the contract between Century and American was a "[f]ixed services, not a per item contract" and was "for the job. It was for the services rendered.... It wasn't for X number of feet of striping. It was for pavement markings at the job ...." The court found that Century "completed the job as requested" and "fulfilled its obligation. It did the job that it was asked to do.... [T]here was ... [c]omplete performance of the contract." The court continued:

> And then American Sewer Services, as the contractor, told the City of Waukesha the job is done, pay **[***4]** us the $11,000. The City of Waukesha paid them that amount.
>
> American Sewer Services didn't say, hey, we got it **[*747]** done for $3,007.00 so let's cut it off the contract. No.[3] [American] took the money because the job was done, quite honestly. Did they apply it to some other aspects of the job? I think so. There was that testimony. There was ... other landscaping that needed to be done.

The court found that American "fail[ed] ... to meet [its] obligation" to Century, **[**35]** adding "you know, American Sewer Services at or before the time of the commencement of the job could have anticipated the diminishment of work that was going to be needed. Could have renegotiated the contract. Could have asked to review and renew the negotiations, but they chose not to do that for whatever reason." The court found that American breached its contract with Century, and it ordered American to pay to Century the remaining $7238 of the $10,245 bill.

P6 The circuit court "wrestl[ed]" more with the ***theft by contractor*** cause of action.[4]

> [A]s [counsel for Century] said, really if you parse out the elements, you have it all there. It's all there. Did Century Fence provide goods or services? They did. Did they meet their obligation? **[***5]** Did American Sewer Services receive payment for the subcontractor services? Yes, they did. Did they pay it to Century Fence? They did not.

The circuit court determined, however, that "by a hair's breath" Century failed to meet its burden of proof with regard to its ***theft by contractor*** claim be **[*748]** cause "American Sewer was solvent and always able to pay the contested amount due and owing" and "there was an arguably viable issue as to the value of the work performed by Century Fence." Century appeals.

Discussion

P7 Century asserts that the circuit court erred in determining that it failed to prove ***theft by contractor***. We agree.

HN1[↑] P8 Where the circuit court acts as the trier of fact, as in this case, we will not upset the court's findings unless they are clearly erroneous. *See* *Wis. Stat. § 805.17(2)*; ***Farrell v. John Deere Co.***, *151 Wis. 2d 45, 62, 443 N.W.2d 50 (Ct. App. 1989)*. Interpretation and application of the law to those facts, however, is a matter of law we review de novo. ***Phelps v. Physicians Ins. Co. of Wis., Inc.***, *2009 WI 74, ¶¶35-36, 319 Wis. 2d 1, 768 N.W.2d 615*.

P9 Pursuant to *Wis. Stat. §§ 895.446*, *779.16*, and *943.20(1)(b)*,[5] Century **[**36]** seeks treble damages

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[3] Nor did American pass along to Waukesha the $750 discount from Century on the final bill.

[4] The circuit court also wrestled with—and rejected—the conversion claim, but Century is only appealing the ***theft by contractor*** claim. Thus, we deem it to have abandoned the conversion claim.

[5] *Wisconsin Stat. § 895.446* provides in relevant part:

> **(1)** Any person who suffers ... loss by reason of intentional conduct ... that is prohibited under ... *[Wis. Stat. §]943.20* ... has a cause of action against the person who caused the ... loss.
>
> **(2)** The burden of proof in a civil action under sub. (1) is with the person who suffers ... loss to prove a violation of ... *[Wis. Stat. §]943.20* ... by a preponderance of the credible evidence....

(3) If the plaintiff prevails in a civil action under sub. (1), **[***7]** he or she may recover all of the following:

(a) Actual damages ....

(b) All costs of investigation and litigation that were reasonably incurred, including the value of the time spent by any employee or agent of the victim.

(c) Exemplary damages of not more than 3 times the amount awarded under par. (a)....

Wisconsin Stat. § 779.16 provides in relevant part:

> **Theft by contractors**. All moneys ... paid ... to any prime

and other remedies for ***theft by contractor***. For these remedies, **[*749]** Century must have established at trial that American committed criminal ***theft by contractor***. As **[*750]** relevant to this case, Century needed to prove by a preponderance of the evidence that (1) American acted **[***6]** as a prime contractor; (2) American received money from Waukesha for public improvements; (3) American intentionally used, retained, or concealed the money "for purposes other than the payment of bona fide claims for labor or materials prior to the payment of such claims"; (4) the use, retention, or concealment was without Waukesha's consent and was contrary to American's authority; (5) American knew the use, retention or concealment was without Waukesha's consent and contrary to its authority; and (6) American used, retained, or concealed the money with the intent to convert it to its own use or the use of another. *See* ***Tri-Tech Corp. of Am. v. Americomp Servs., Inc.***, *2002 WI 88, ¶¶26, 30, 43, 254 Wis. 2d 418, 646 N.W.2d 822* ("To sustain a cause of action for treble damages ... the elements of both [*Wis. Stat. §§ 779.02*[6] and *943.20*] must be proven."); *see also §§ 779.16*, *943.20(1)(b)*.

> contractor ... for public improvements are a trust fund ... in the hands of the prime contractor ... to the amount of all claims due or to become due or owing from the prime contractor ... for labor, services, materials, plans, and specifications performed, furnished, or procured for the improvements, until all the claims have been paid .... The use of any such moneys by any prime contractor ... 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 ... is theft by the prime contractor ... of moneys so misappropriated and is punishable under *[Wis. Stat. §]943.20*. If the prime contractor ... is a corporation, limited liability company, or other legal entity other than a sole proprietorship, such misappropriation also shall **[***8]** be deemed theft by any officers, directors, members, partners, or agents responsible for the misappropriation.
>
> *Wisconsin Stat. § 943.20* provides in relevant part:
>
> **Theft. (1)** ACTS. Whoever does any of the following may be penalized as provided in sub. (3):
>
> ....
>
> (b) By virtue of his or her office, business or employment, or as trustee or bailee, having possession or custody of money ... of another, intentionally uses, transfers, conceals, or retains possession of such money ... without the owner's consent, contrary to his or her authority, and with intent to convert to his or her own use or to the use of any other person except the owner. A refusal to deliver any money ... which is in his or her possession or custody by virtue of his or her office, business or employment, or as trustee or bailee, upon demand of the person entitled to receive it, or as required by law, is prima facie evidence of an intent to convert to his or her own use within the meaning of this paragraph.

P10 Though the circuit court found that Century failed to meet its burden of proving ***theft by contractor***, it did not specifically identify which of these six elements was not satisfied. The court expressed that the only reasons it concluded that Century had not met its **[***9]** burden "by a hair's breath" was "due to the fact that American Sewer was solvent and always able to pay the contested amount due and owing, and because there was an arguably viable issue as to the value of the work performed by Century Fence." As **[*751]** best we can tell based on the court's ruling and the arguments on appeal, these conclusions were that Century failed to sufficiently prove the third and sixth elements above—that American intentionally used, retained, or concealed the money (that had been received from Waukesha) "for purposes other than the payment of bona fide claims for labor or materials prior to the payment of such claims" and used, retained, or concealed the money with the intent to convert it to its own use or the use of another. *See* ***Tri-Tech***, *254 Wis. 2d 418, ¶¶26, 30*.

P11 Related to these elements, American asserts in its appellate briefing that our **[**37]** supreme court in ***Tri-Tech*** "specifically held that placement of money into a bank account, even though that account may be encumbered by a security interest, is insufficient to establish a prima facie case of specific criminal intent." ***Tri-Tech*** did not hold this. Rather, ***Tri-Tech*** held that *if* the record lacks evidence "as to demand and refusal to pay," **[***10]** admission to "depositing the payment ... into a bank account encumbered by a security interest is insufficient *by itself* to establish a prima facie case of specific criminal intent." ***Tri-Tech***, *254 Wis. 2d 418, ¶32* (emphasis added). In the case now before us, there was a demand by Century and a refusal to pay by American, and American's depositing of the $11,000 into its general account was not the only evidence of American's intent.

P12 In October 2016, Century billed American $10,245

[6] The statute at issue in ***Tri-Tech Corp. of America v. Americomp Services, Inc.***, *2002 WI 88, 254 Wis. 2d 418, 646 N.W.2d 822*, was *Wis. Stat. § 779.02*. Here, *Wis. Stat. § 779.16*, the ***theft-by-contractor*** statute for public projects, is at issue. The two statutes are substantially the same.

for the pavement-marking services it had completed for American. Despite Waukesha paying American the funds for these services, American, by Biondich's letter of March 1, 2017, refused to pay Century the amount owed. A week later, Century again demanded payment from American, which American **[*752]** again did not provide. Even when Century demanded payment from American a third time, this time through counsel, American continued to refuse to pay Century the contracted amount—instead merely transferring $11,000 to the client trust account of American's own counsel. More than a year after American sent its initial refuse-to-pay letter to Century, Century was forced to initiate this lawsuit in order to recover what it was owed and should have **[***11]** been paid by American long before.

P13 *Wisconsin Stat. § 943.20*—theft—provides in *paragraph (1)(b)*: "A refusal to deliver any money ... which is in his or her possession or custody ... as trustee ..., upon demand of the person entitled to receive it, or as required by law, is prima facie evidence of an intent to convert to his or her own use within the meaning of this paragraph." *See* ***Tri-Tech**, 254 Wis. 2d 418, ¶32* (concluding "proof of refusal to pay contractor funds on demand of one entitled to receive them" constitutes prima facie evidence of criminal intent as "specifically approved in the statute"). Once Waukesha paid American the $11,000 for the pavement-marking services performed by Century, American became the trustee of those funds and was required to pay Century the $10,245 that it demanded and was owed. *See Wis. Stat. § 779.16*; ***Tri-Tech**, 254 Wis. 2d 418, ¶25*; ***Loehrke v. Wanta Builders, Inc.**, 151 Wis. 2d 695, 702, 445 N.W.2d 717 (Ct. App. 1989)*. American could not lawfully retain any of the funds for its own purposes until it paid Century's $10,245 claim on the contract; yet, the circuit court found, based on Biondich's related testimony, that Century placed the $11,000 in its general account and that "[m]oney in the American Sewer general account, including money received from **[*753]** Waukesha for work performed by Century Fence, [was] used to pay American Sewer's expenses, **[***12]** employees, etc." ***HN2***[⬆] As our supreme court stated in ***Burmeister Woodwork Co. v. Friedel**, 65 Wis. 2d 293, 298, 222 N.W.2d 647 (1974)*, where funds are used for "the ordinary and normal expenses of the business," they are used "for purposes other than the payment of claims as provided in the statute," which is "the only important point." Because "payments made to a prime contractor [like Waukesha's payment to American] are not actually owned by the prime contractor," *see* ***State v. Keyes**, 2008 WI 54, ¶29, 309 Wis. 2d 516, 750 N.W.2d 30*, American "could do only one thing with the trust funds and that was to pay the subcontractor[]," Century, *see* ***State v. Blaisdell**, 85 Wis. 2d 172, 179, 270 N.W.2d 69 (1978)*. "Only after that was done was [it] entitled **[**38]** to use [excess] funds for corporate purposes." *See* ***Burmeister**, 65 Wis. 2d at 300*.

P14 The circuit court's statement that Century did not prove American committed ***theft by contractor*** because American "was solvent and always able to pay the contested amount due and owing" appears to be a statement that for this reason Century did not prove that American intentionally used the money from Waukesha for purposes other than the payment of Century's claim (third element) and/or did not prove that American used, retained, or concealed the money with the intent to convert it to its own use or the use of another (sixth element). *See* ***Tri-Tech**, 254 Wis. 2d 418, ¶¶26, 30*. **[***13]** The court's determination that Century did not prove its ***theft by contractor*** claim because American was "solvent and always able to pay" is incorrect as a matter of law.

[*754] P15 Biondich conceded that the money Waukesha paid American for Century's pavement-marking services went into American's general account "[t]hat is used for American Sewer's benefit to pay employees and obligations." As noted, the circuit court relatedly found that "[m]oney in the American Sewer general account, including money received from Waukesha for work performed by Century Fence, [was] used to pay American Sewer's expenses, employees, etc." The evidence unquestionably showed that American retained and used the $10,245 it owed Century, including the $3007 that American itself indisputably acknowledged it owed, for a "purpose" other than paying Century—to support American's general account for payment of its own business obligations. Because American refused to even pay Century the $3007, it appears American was also using the full $10,245 as leverage to try to get Century to capitulate and waive the additional $7238 owed on the contract.

P16 Additionally, at trial, Steve Klomsten, the project manager for American, **[***14]** testified that American considered the difference between the $11,000 Waukesha paid it and the $3007 admittedly owed to Century to be rightfully American's to keep as a means of payment from Waukesha to American for additional work American completed on the job but for which American did not bill Waukesha. As the circuit court

found, American "appl[ied] [that difference] to some other aspects of the job.... There was that testimony. There was ... other landscaping that needed to be done." American does not dispute this finding.[7] The evidence showed that American used a significant portion of the $11,000 Waukesha paid it for Century's **[*755]** services to instead pay itself for other work it did on the job. American also committed ***theft by contractor*** in this way as it "could do only one thing with the trust funds and that was to pay the subcontractor[]," Century. *See* ***Blaisdell***, *85 Wis. 2d at 179*. As stated, "[o]nly after that was done was [American] entitled to use [excess] funds for corporate purposes." *See* ***Burmeister***, *65 Wis. 2d at 300*.

P17 American contends that it cannot be held liable for ***theft by contractor*** because it paid Century $3007 after Century filed this suit and paid the remaining balance of $7238 after the circuit court **[***15]** ruled that American breached the contract and ordered it to make that latter payment. American, however, could not cure **[**39]** its theft once the crime was completed. *See* ***State v. Sobkowiak***, *173 Wis. 2d 327, 336, 496 N.W.2d 620 (Ct. App. 1992)* ("Sobkowiak could not cure his theft by ultimately repaying the funds diverted to his personal use or by satisfying the claims of the laborers and materialmen after his offense was complete."); *see also* ***KBS Constr., Inc. v. McCullough Plumbing, Inc.***, *No. 2008AP1867, 2010 WI App 19, 323 Wis. 2d 276, 779 N.W.2d 723, unpublished slip op. ¶23 (WI App Dec. 23, 2009)* (***Theft by contractor*** "occurs at the time the funds are misappropriated."); ***Blaisdell***, *85 Wis. 2d at 180* (If the requisite wrongful intent "did exist at the time [of 'the deposit and subsequent use of the funds by the defendant for his own benefit'], even a contemporaneous intent to pay back the money at a later time would be of no legal consequence."). Were American's position the law, no one could ever be held liable, civilly or criminally, for theft so long as he or she returned the **[*756]** stolen funds or object once caught. American had no lawful basis to withhold any funds from Century or to do anything with the payment from Waukesha other than pay Century the contracted amount. The ***theft-by-contractor*** statute does not allow for what occurred here—a prime contractor paying itself from moneys **[***16]** it held in trust for a subcontractor prior to paying what is owed to that subcontractor and holding hostage money owed to a subcontractor in an effort to get the subcontractor to accept less than the contracted price by forcing the subcontractor to choose between hiring lawyers and initiating an expensive lawsuit or agreeing to the lesser amount.

P18 American further asserts that "it is impossible to conclude that [American] had converted the money to [its] own use, when in fact ... upon learning of the potential claim [by Century], the entire contract amount was immediately placed into trust" "pending the outcome of the case." Of course this was not payment to Century but placement into the trust account of *American's* attorney—after American's crime was complete and Century had to hire counsel. Even this trust-account maneuver by American was almost a year after American had refused Century's first demand for payment and Century made its second demand. This maneuver amounted to little more than a continued refusal to pay Century the $10,245 it owed, including the $3007 that American acknowledged it owed. American refused to pay the contracted amount when requested, retained and used **[***17]** the funds due to Century, and had no arguably lawful basis to do so. This constituted "prima facie evidence of an intent to convert [the money] to [American/Biondich's] own use within the meaning of this paragraph." *See* *Wis. Stat. § 943.20(1)(b)*.

[*757] P19 Despite finding that American breached the contract with Century, the circuit court, it seems, determined that Century also did not meet the third element of ***theft by contractor*** because it believed there was "some question" about "the value of the work done" by Century. We presume the court was suggesting that there was a "bona fide dispute."[8] We believe the court erred.

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[7] Klomsten's testimony and the circuit court's finding to this effect is also consistent with Biondich's confirmation at trial that American did additional asphalt paving, landscaping, and "some additional ... water laterals" on the Waukesha job that it "did not bill for."

[8] *Wisconsin Stat. § 779.16* provides in part that

> [t]he use of any such moneys by any prime contractor ... 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 ... is theft by the prime contractor ... of moneys so misappropriated and is punishable under *[Wis. Stat. §] 943.20*.

A "bona fide" dispute means a dispute that is "real, actual, genuine" and "in fact exists and is not merely pretextural or feigned on the part of the [party] in an attempt to avoid his [or her] obligations under the law." See ***Kansas City Star Co. v. DILHR***, *60 Wis. 2d 591, 601, 211 N.W.2d 488 (1973)*.

[40]** P20 Based on the undisputed evidence at trial and the circuit court's findings, when Century arrived at the job site, there ended up being less work for it to do than originally expected. But, as the court also found, and correctly so, the contract was a fixed fee/lump-sum **[***18]** contract for "the job." The contract in no way suggests that the amount due to Century depended on how much pavement marking was required in order for Century to complete the job. Thus, where Century undisputedly completed the job as the contract required, a question about how much work was necessary to complete the job is irrelevant to the question of what was owed to Century under the contract. American had no legitimate ground for withholding payment simply because it, after-the-fact, may **[*758]** have regretted not negotiating the contract differently.[9] There was no bona fide dispute.

P21 Finally, American states that "in ***Loehrke v. Wanta Builders, Inc.***, *151 Wis. 2d 695, 445 N.W.2d 717 (Ct. App. 1989)*, the court held that the contractor who fails to pay over the amount due does not violate the fiduciary duty owed under *[Wis. Stat.] § 779.16*." Not quite. ***HN3***[⬆] We actually held that "refusal *with good cause* to pay a disputed amount on contract cannot and should not be a tort. If the prime contractor has *good cause* to refuse to pay, it has not violated its fiduciary duty, no tort results and punitive damages are unavailable." ***Loehrke***, *151 Wis. 2d at 704* (emphasis added). The obvious difference in this case, is that American had no "good cause" to refuse to pay the contracted amount to Century.

P22 For the foregoing reasons, **[***19]** we conclude the circuit court erred in determining that Century failed to prove ***theft by contractor***.

By the Court.—Order reversed and cause remanded for further proceedings.

Recommended for publication in the official reports.

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[9] While it would be a different question if there was a "bona fide dispute" based on the quality of Century's work, American never indicated that such an issue served as a basis for it to withhold Century's money.