UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
MICHAEL BRUCE SEXSON,	)	CASE NO. BK78-0-1046
	)	
BANKRUPT	)	
	)	
THOMAS W. KELSEY and JACQUELINE R. KELSEY,	)	
	)	
Plaintiffs	)	
	)	
vs.	)	
	)	
MICHAEL BRUCE SEXSON,	)	
	)	
Defendant	)	

Appearances: James R. Nisley, Attorney
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MEMORANDUM OPINION

Michael Bruce Sexson, the defendant, entered into a contract to construct a residence for Thomas W. and Jacqueline R. Kelsey, the plaintiffs. Mr. Sexson failed to pay in full his subcontractors who supplied services and material for the project and the subcontractors filed mechanics' liens against the property. The Kelseys seek a determination that the breach of contract claim which they have against Mr. Sexson for failing to pay subcontractors is nondischargeable in this bankruptcy proceeding.

In August of 1977, the Kelseys and Mr. Sexson came to an agreement as to what type of house the defendant would construct for the Kelseys, subject to finding appropriate financing. The

Kelseys submitted a loan application to First Federal Savings and Loan Association of Lincoln which was later approved in the amount of $34,700.00. After that approval was obtained, Mr. Sexson advised the Kelseys that he needed $3,000.00 to start the project. The Kelseys obtained a second short-term loan from another entity and paid the money to Mr. Sexson. Mr. Sexson commenced construction and the work progressed. The arrangement between the Kelseys and First Federal was that the Kelseys authorized First Federal to make periodic progress disbursements directly to Mr. Sexson. On October 5, 1976, First Federal made an inspection of the project and found no work had been completed and, accordingly, made no disbursement to Mr. Sexson. Subsequent inspections were conducted on December 2, 1976, January 14, 1977, February 14, 1977, and March 24, 1977. Following each of the inspections, First Federal made a disbursement to Mr. Sexson based upon First Federal's appraisal of the percentage of work completed. First Federal's final inspection indicated 100% completion. Following the final inspection, First Federal had disbursed slightly in excess of $32,000.00.

Unfortunately for all parties, the defendant's estimate of the cost of construction was apparently exceeded by the actual cost. Following the closing conference at which defendant submitted his final bill, it became apparent to the parties that unless the defendant were paid more than what the plaintiffs believed was the contract price, defendant would be unable to pay all his subcontractors and materialmen. Negotiations failed and mechanics'liens in excess of $6,000.00 were filed.

Plaintiffs' third cause of action premises nondischargeability on the contention that defendant obtained money or property by false pretenses or false representations in violation of §17a(2) [11 U.S.C. §35a(2)]. However, the evidence before me fails to

support that contention. The defendant's representation that he needed the initial $3,000.00 to start construction has not been shown to have been false. The periodic disbursements by First Federal were made upon their inspection and analysis of the extent of work completed and were not made on the basis of representations by the defendant. The only possible representation by the defendant was a suggestion prior to the final disbursement that one subcontractor was unpaid and would be paid. However, the Court is unconvinced that defendant made that promise of payment with the requisite guilty scienter. Promises by bankrupts to pay debts in the future are hardly rare and failure to perform those promises do not, in and of themselves, render the indebtedness nondischargeable. As to this issue, the plaintiffs have failed to maintain their burden of proof.

The other basis for a determination of nondischargeability is §17a(4)[11 U.S.C. §35a(4)] which excepts from discharge debts created by the debtor's "fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity." The plaintiffs point to the evidence before me which discloses that the defendant paid himself for work which he had done on the project personally at a time when there were unpaid subcontractors who could file mechanics' liens. The plaintiffs argument points to Neb. Rev. Stat. Sec. 52-123 and Sec. 76-239.01 and .02.

Plaintiffs acknowledge the Eighth Circuit's ruling that Neb. Rev. Stat. Sec. 52-123 does not create the type of fiduciary relationship contemplated by §17a(4) of the Act.[1]

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1. Neb. Rev. Stat. Sec. 52-123 creates criminal liability for a contractor's failure to apply construction proceeds toward the lawful claims of anyone who would be entitled to file a laborer's or materialmen's lien against the property. The Eighth Circuit applied Nebraska Supreme Court rulings and held that this statute does not make construction proceeds into trust funds. In re Dloogoff ____F.2d_____, No. 79-1036 (8th Cir. June 14, 1979).

However, plaintiffs argue that other Nebraska statutes are applicable to the case before us and that those statutes do create a fiduciary status which falls within the scope of §17a(4).

The statutes are Neb. Rev. Stat. §§76-239.01 and .02, which state:

> "76-239.01. Mortgage; financing construction; proceeds to apply payment of lawful claims for labor and material furnished; duty of contractor. Any person, firm or corporation lending money for the purpose of financing the construction of improvements on real property, to be secured by a mortgage filed of record, is hereby required, before the disbursement of any proceeds under such loan, to notify the borrower in writing, separate from any written application, mortgage note, or any other loan document between the lender and the borrower, that it is the responsibility of the borrower or the borrower's contractor, if disbursements are to be made to such contractor, to apply the loan proceeds to the payment of lawful claims for labor and material furnished for such improvements and that failure of the borrower or his contractor to pay all lawful claims for labor and material could result in the filing of mechanic's liens against the property. It shall be the duty of the contractor to whom any such disbursement is made to make such application of the loan proceeds.
>
> "76-239.02. Contractor receiving loan disbursement; agent of borrower; exception. Any such contractor receiving such loan disbursements and any funds of the borrower in addition to such loan disbursements shall be deemed to have consented to comply with the requirements of section 76-239.01 as to the application of such proceeds, and shall be deemed to be the agent of the borrower for so much of such proceeds as are necessary for the payment of such lawful claims for labor and material; Provided, that the foregoing provisions shall not apply where the contractor and the borrower are one and the same person. Nothing herein contained shall be construed to require the contractor to keep such proceeds in a separate account or accounts or to prorate payment of such proceeds to such lawful claims for labor and materials."

The Nebraska Supreme Court has not yet considered the meaning of §79-239.02, the statute which forms the basis for plaintiffs' claim of nondischargeability. The Court has stated in another context that agency is a fiduciary relationship. Reeves v. Associates Financial Services Co., Inc., 197 Ne. 107, 114, 247 N.W.2d 434 (1976).

However, the fiduciary nature of the agency relationship is insufficient, by itself, to bring a debt arising out of that relationship within the scope of §17a(4) of the Bankruptcy Act. Noble v. Hammond, 129 U.S. 65, 9 S.Ct. 235, 32 L.Ed. 621 (1889) See also 1A Collier on Bankruptcy para. 17.24 [4] at 1708-09 (14th ed. 1978); Davis v. Aetna Acceptance Corp., 293 U.S. 328, 55 S.Ct. 151, 79 L.Ed. 393 (1934). Hamby v. St. Paul Mercury Indem. Co., 217 F.2d 78 (4th Cir. 1954), cited by plaintiff is distinguishable. That case involved the misappropriation of buyers' funds by a real estate agent. The Fourth Circuit, applying Virginia law, found that real estate agents had a fiduciary relationship to their clients similar to the attorney-client relation. Id. at 80. Such a special relationship does not exist in the case before this Court, either under Nebraska case law or by virtue of the statute in question here.

Several states have enacted statutes providing that construction funds paid to a contractor are trust funds until all lienable claims are paid. As one court has noted;

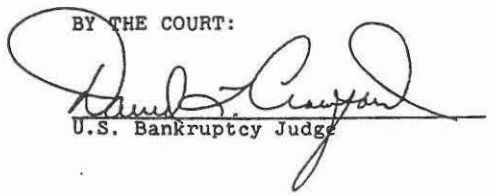
> "[W]hile once there was considerable doubt as to whether lien-trust statutes. . .created the express trust that 17a(4) contemplates, all of the tide of recent authority is to the effect these statutes do create that fiduciary relationship. The Courts are now finding that express trusts exist under these statutes, that the parties are constructively charged with an intent to enter into a trust by making a contract subject to such laws, and the trust arises prior to rather than by virtue of the claimed misappropriation of trust funds."

In re Bell, 4 Bankr. Ct. Dec. 410 (N.D. Tex. 1978) (Gandy, Bankruptc Judge). However, Neb. Rev. Stat. §76-239.02 merely creates an agency relationship and explicitly negates any implication of a trust by permitting the contractor to commingle funds. My conclusion is that this statute is insufficiently explicit in terms of an express trust relationship to bring the defendant within §17a(4).

Given the foregoing, my finding is in favor of the defendant and against the plaintiffs. A separate judgment is entered in accordance with the foregoing.

DATED: December 26, 1979.

BY THE COURT:



U.S. Bankruptcy Judge

Copies mailed to the attorneys who appeared.