

CONSTRUCTION TRUST FUNDS

In Wisconsin, funds paid on a construction project to a prime contractor or subcontractor which originate from an owner or a mortgage holder constitute a “trust fund,” which must be preserved until all legitimate claims for labor and materials have been paid. A fiduciary relationship is created when the contractor receives the funds. The beneficiaries of this fiduciary relationship are the owner and suppliers of labor and materials.

Wisconsin has two trust fund statutes. Section 779.02(5), Wisconsin Statutes, applies to private construction projects. Section 779.16 applies to public improvement projects. These are known as the “theft by contractor” statutes.

Trust funds in the hands of a prime contractor or subcontractor can only be used to pay for labor and materials for the project from which the funds originated. They cannot be used for obligations from a prior project, or for a new project. However, a contractor can reimburse itself for payments made by the contractor for labor and materials on the project from which the funds originated.

Violation of the trust fund statute can constitute a crime. Under section 943.20, Wisconsin Statutes, the crime of “theft” is defined broadly enough to include violations of the trust funds statutes. If the amount exceeds \$2,500, it can be punishable as a felony.

Shareholders of a corporation which violates the trust fund statute can be liable for misappropriation of trust funds if the misappropriated funds are received by the shareholder as salary, loan repayment, or a capital distribution. Officers, directors or agents of the corporation can be held liable if they are involved in the misappropriation, or if they are aware of it and fail to act to prevent the misappropriation.

Civil penalties for breach of the fiduciary duty include more than recovery of the amount misappropriated. Treble damages (three times the amount misappropriated) can be awarded under section 895.446, Wisconsin Statutes, in certain circumstances. The successful claimant may also be able to recover its actual attorney fees from the offending party.

Violations of the trust fund statutes can be significant in a contractor bankruptcy proceeding. Under section 523(a)(4) of the Bankruptcy Code, a debt can be excepted from discharge if it arose as a result of a misappropriation from a fiduciary relationship. Therefore, a contractor who violates the trust fund statute may not be able to escape liability by filing for bankruptcy.

Violations of the trust fund statutes occur for a variety of reasons, including undercapitalization, poor bookkeeping, and ignorance of the obligations imposed under the trust fund statutes. For trust fund beneficiaries, such as subcontractors and material suppliers, the trust fund statutes provide tools for enhancing the prospects for recovery of payment.

When faced with a situation involving possible violations of the trust fund statute, it is important to seek competent legal advice to protect your rights.