

MISUSE OF CONSTRUCTION MONIES - WHEN A CONTRACTOR FAILS TO PAY HIS SUBCONTRACTORS, CRIMINAL PENALTIES CAN RESULT

In the design professions and construction business it is well known that when a prime contractor is paid by the owner, the contractor receives those funds imbued with a trust created by the Wisconsin Statutes. Section 779.02(5) of the Wisconsin Statutes provides that any such payments constitute a trust fund in the hands of the prime contractor or subcontractor for the benefit of all those that are owed for labor and materials used by the prime contractor or subcontractor in the course of making the real estate improvements. The trust fund continues to exist until all claims against it have been paid. The use of the money constituting the trust fund by any prime contractor or subcontractor before all claims are paid is theft by contractor and punishable by fine and imprisonment under the Wisconsin Criminal Code. Not only the construction company is guilty of theft when the trust monies are misappropriated, but the contractor officers, directors or agents responsible for the misappropriation are also guilty. The entire subject matter of the misuse of construction monies by a prime contractor or a subcontractor is a weighty subject indeed.

Recently the Wisconsin Supreme Court made the burden even heavier. In *Tri-Tech Corporation of America v. Americomp Services, Inc.*, decided by the Wisconsin Supreme Court on July 3, 2002, the court held that treble damages are available to an unpaid subcontractor or supplier who is not paid from the trust fund proceeds.

In *Tri-Tech Corp. v. Americomp Services*, Americomp was hired by the Frantz Group to install a computer network in the Frantz Group's offices. Americomp in turn hired Tri-Tech Corporation to provide some of the necessary materials and labor. The work was performed and the Frantz Group paid Americomp. However, Americomp did not pay Tri-Tech and Tri-Tech sued.

Americomp and its president and sole shareholder were named as defendants. Americomp and its president filed an answer to Tri-Tech's complaint admitting receipt of the construction proceeds from the owner and admitting nonpayment of Tri-Tech.

The circuit court granted summary judgment against Americomp in the amount of the contract balance due Tri-Tech in the sum of \$22,107.24, and then Tri-Tech moved for summary judgment against Americomp's president seeking the recovery of treble damages in the amount of \$83,423.85. Tri-Tech submitted the president's answers to written interrogatories in which the president admitted that the money received from the Frantz Group as construction payments was placed in Americomp's business manager account which was subject to a general security agreement in favor of the bank. Americomp's president argued that §895.80 of the Wisconsin Statutes providing for the recovery of treble damages did not expressly list §779.02 (the theft by contractor statute) as a statute that would trigger treble damages. He also argued that the work involved was the installation of a computer network and that a computer network did not constitute an improvement of real estate. Finally, Americomp's president argued that the treble damage statute only applied if there was evidence of an intentional violation and he denied that he intentionally had misappropriated any of the monies.

The circuit court held that the criminal code referenced the misappropriation of funds by a contractor or subcontractor as being theft and therefore concluded that the treble damage statute was triggered and available to Tri-Tech. The circuit court also concluded that installing a computer network was improving real estate as being similar to electrical wiring. Finally, the circuit court held that the intention required to trigger the criminal statute was simply an intention to act and did not require an intention to commit a criminal act.

Americomp's president appealed and the Court of Appeals affirmed the circuit court. The Court of Appeals noting however, that there was a difference between criminal and civil theft by a contractor, said "The difference is that the criminal statute requires wrongful intent and the civil statute does not."

The Wisconsin Supreme Court accepted review of this issue primarily to clarify what proof of intent was required in order to entitle a claimant to treble damages.

The Supreme Court observed that a statute creating treble damages is regarded as punitive rather than remedial, and is therefore strictly construed if it is ambiguous. The court noted that the legislature when enacting the treble damage statute stated that the burden of proof upon the claimant for treble damages was to prove his case by a preponderance of the evidence which is the lowest burden of proof. The higher and more traditional burden of proof for such cases had been established at common law as being evidence that was "clear, satisfactory and convincing."

The Supreme Court also noted that the elements of the criminal offense of theft by contractor are (1) the defendant acted as a prime contractor, (2) the defendant received money for the improvement of land from the owner or mortgagee, (3) the defendant intentionally used the money for purposes other than the payment of bonafide claims for labor and materials prior to the payment of such claims, (4) the use was without the owner or mortgagee's consent and contrary to the contractor's authority, (5) the contractor defendant knew the use was without consent and contrary to his authority, and (6) the defendant contractor used the money with the intent to convert it to his own use or the use of another.

The Wisconsin Supreme Court held that a specific criminal intent which makes the offense punishable under criminal law was also required under civil law to succeed in pursuing a civil claim for treble damages. It held that under the treble damage statute, §895.80 of the Wisconsin Statutes, the subcontractor or the material supplier suing for treble damages for theft by contractor must prove "by a preponderance of the evidence all 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 the intent to convert such funds to his own use or the use of another."

The Supreme Court then remanded the case to the circuit court for a trial on the question of whether Americomp's president had the necessary specific criminal intent to misappropriate the funds that would sustain the treble damage claim.

While the issue of what evidence of intent must be proven in order to successfully recover treble damages was the central issue in the case, the Supreme Court also noted that a real estate improvement required the following rules or tests: "(1) actual physical annexation to the real estate; (2) application or adaption to the use or purpose to which the realty is devoted; and (3) an intention on the part of the person making the annexation to make a permanent accession to the freehold." The court held that an improvement of real estate required a permanent benefit to the land. The Supreme Court said, "We cannot address the question of whether only one reasonable conclusion can be drawn from the evidence for the simple reason that there is no evidence in the record as to whether the computer network cabling comprised an 'actual physical annexation' to the property, was an 'application or adaptation to the use or purpose' of the property and was intended to be permanent." The court held that there was a factual dispute as to whether the computer network cabling was an improvement and therefore that issue would also have to be decided by the circuit court when it heard evidence as to the presence or absence of the specific criminal intent.

From time immemorial, the design and construction of real estate improvements has involved the question of legal remedies existing as a result of misappropriation of construction monies. It is all too evident that construction is primarily financed by cash flow coming from mortgage lenders and passing through contractors on its way to the ultimate provider of labor and materials. The Tri-Tech case is important in understanding the remedies available to an unpaid provider of construction labor or materials.

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