

# ECONOMIC DOWNTURN NOT A DEFENSE TO ALLEGED VIOLATIONS OF MICHIGAN'S BUILDERS TRUST FUND ACT

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The Michigan Court of Appeals, in *Livonia Building Materials Company v Harrison Construction Company*, 276 Mich. App. 514; \_\_\_NW2d \_\_\_ (2007), recently concluded that the difficulties posed by a downturn in the economy or poor business acumen do not excuse the Michigan Builders Trust Fund Act's (MBTFA) obligations in regard to accounting practices and ordering of payment.

The court held that the defense that there was not enough money to go around was not sufficient to rebut the presumption of misappropriation contained in the MBTFA, MCL 570.153.

The court also examined the "intent to defraud" requirement in conjunction with the contractor's defense that the project was sideways and that the contractor did not receive enough money from the owner to pay all the subcontractors, laborers and materialmen.

In this case, Livonia Building Materials Company (Livonia) obtained a judgment via jury verdict against two corporate officers of a construction company to whom they provided building materials for use in the construction of commercial and retail buildings. It was not disputed that the construction company had received payment on projects for which Livonia had supplied materials, yet the construction company did not pay Livonia in full for the material it provided. The company had gone out of business and, therefore, Livonia brought claims against the corporate officers individually.

The corporate officers defended the claim by presenting evidence that projects to which Livonia provided materials were "upside down," meaning that there was just not enough money to pay all the parties who worked on the particular job. However, the defendants admitted that monies were paid out of the construction company's general account to others than laborers, subcontractors or materialmen, who are protected by the MBTFA, MCL 570.151, et. seq., after receipt by the construction company.

This is significant because the MBTFA imposes a trust on funds paid to contractors and subcontractors for products and services provided under construction contracts for private projects.

The act also regulates the time honored practice of applying funds from one project to pay the

expenses on another project or general business expenses. Contractors and their corporate officers can be subject to both civil and criminal liability when they pay general corporate business expenses or expenses related to another project before first paying subcontractors, laborers or materialmen, for whose work payment was received.

To establish a claim under the MBTFA, a plaintiff must show: (1) that the defendant is a contractor or subcontractor engaged in the building construction industry, (2) that the defendant was paid for labor or materials provided on a construction project, (3) that the defendant retained or used those funds or any part of those funds, (4) that the funds were retained, with intent to defraud, for any purpose other than to first pay laborers, subcontractors and material men, and (5) that the laborers, subcontractors and materialmen were engaged by the defendant to perform labor or furnish material for the specific construction project. *HA Smith Lumber & Hardware Co v Decina*, 258 Mich. App. 419, 426; 670 NW2d 729 (2003), vacated in part on other grounds 471 Mich. 925 (2004).

In many of the civil or criminal cases regarding the MBTFA, at issue is what constitutes "intent to defraud" under the act. The MBTFA defines the intent requirement as follows:

The appropriation by a contractor, or any subcontractor, of any monies paid to him for building operations before the payment by him of all monies due or so to become due to laborers, subcontractors, materialmen or others entitled to payment, shall be evidence of the intent to defraud. MCL 570.153

Although the corporate officers may not have acted with bad faith and, indeed, were simply trying to keep their ongoing concern afloat by paying the most urgent outstanding balances, the MBTFA's requirements must still be followed, and the defendants were certainly required to pay the plaintiff on its projects when monies came in for those particular projects. But the appropriations of any monies paid to a contractor for building operations before payment of the protected parties, in this case the materialmen, shall be evidence of intent to defraud. MCL 570.153

To avoid violations of the MBTFA and potential civil and criminal liability, a contractor or a subcontractor receiving funds on a project, who owes to others further down the chain, should make sure to segregate project funds from other uses and make sure that all subcontractors, laborers and suppliers are timely paid. Even though others may need to be paid to keep a business afloat, that will not protect unwary contractors, subcontractors and their corporate officers from liability. If the money a contractor receives on a project is used for its intended purpose under the MBTFA, no civil or criminal liability may arise.

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