



Michigan Court of Appeals Affirms Personal Liability of Corporate Officers Under the Michigan Builder's Trust Fund Act

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Proof that a corporate officer personally misappropriated contract proceeds "is not necessary to find an officer liable" for a violation of the Michigan Builder's Trust Fund Act (MCL 570.151, et seq).

"[A] reasonable inference of appropriation arises from the payment of construction funds to a contractor and the subsequent failure of the contractor to pay laborers, subcontractors, materialmen, or others entitled to payment."

So declared the Michigan Court of Appeals recently in another decision affirming the principle (and risk) of personal liability for the owners of construction companies under the Michigan Builder's Trust Fund Act (MBTFA).

In *BC Tile & Marble Co. v Multi-Bldg Co.*, ___ Mich. App ___, 2010 Mich. App LEXIS 1036 (Mich. Ct App, April 13, 2010), the defendant general contractor built and sold a condominium (Unit

5) to a homeowner. Although the contractor received funds at the closing for Unit 5 to pay his tile and marble subcontractor, the contractor failed to pay the subcontractor citing defective workmanship and delayed performance. The subcontractor, who had recorded and served a construction lien just four days prior to the closing, then filed suit to foreclose his lien, and included a claim against the contractor's president, in his individual capacity, for violation of the MBTFA.

BACKGROUND

The MBTFA provides that upon receipt of payment from the owner, a trust is created for the benefit of contractors, laborers, subcontractors and suppliers, and makes the contractor or subcontractor who receives the payment a trustee of the funds. The MBTFA on

its face is a criminal statute, but the courts have also recognized a civil cause of action under common law. To make out a civil cause of action under the MBTFA, a plaintiff must establish the following elements:

- The defendant is a contractor or subcontractor engaged in the building construction industry;
- The defendant was paid for labor or materials provided on a construction project;
- The defendant retained or used those funds, or any part of those funds;
- The funds were retained for any purpose other than to first pay laborers, subcontractors, and materialmen; and
- The laborers, subcontractors and materialmen who were engaged by the defendant to perform labor or furnish material for the specific construction project.

See, *Livonia Bldg. Materials Co. v Harrison Construction Co.*, 276 Mich. App 514, 519 (2007).

In *BC Tile*, plaintiff asserted that the president of Multi-Bldg Co. was personally liable because he had signed the closing documents that allowed for payment to other contractors, but not BC Tile. The president denied that he had any day-to-day involvement with or exercised any decision-making for the particular condominium project. The president further denied that he had personally received any of the funds at closing. While the Court of Appeals agreed that "there is no evidence here that [the president] personally used the funds owed to BC Tile," it found that these facts were not dispositive of the MBTFA claim.

First, the Court of Appeals reiterated its decision in *People v Brown*, a case arising out of a criminal prosecution under MBTFA: "there is no requirement that contract payments be made directly to the officer of the corporate contractor in order to hold the officer individually responsible under the MBTFA." 239 Mich. App 735, 743-744 (2000).

Second, relying on its 2007 decision involving civil claims, the Court of Appeals noted:

"In *Livonia Bldg.*, the defendant contractor received funds for a project but did not pay the plaintiff in full. The corporate officers gave testimony regarding their decision to put the funds received in various accounts and subsequently, their actions in writing checks to entities other than the plaintiff. This Court found that the individual corporate officers 'acted in direct contravention of the MBTFA.' According to this Court, there was sufficient evidence to create a presumption of

misappropriation and to find the corporate officers individually liable."

The Court of Appeals concluded in *BC Tile* that the president of the construction contractor should not have been dismissed from the case, and reversed the trial court's ruling. The president of the construction company thus faces a trial and a possible personal judgment.

Unfortunately, the court's decision in *BC Tile* is not an isolated incident, but is part of a growing body of law that makes it easier for unpaid subcontractors and suppliers to pierce the corporate veil and reach individual officers and shareholders. A number of cases even go so far as to put the burden of proof on the defendant to account for contract proceeds, rather than the plaintiff who is bringing the lawsuit.

Michigan case law, however, limits claims under the MBTFA to private construction projects. In 1981, the Michigan Supreme Court was asked to interpret coverage of the statute. In doing so, the Supreme Court determined that the MBTFA covered only private work, and was not meant to cover public construction projects. This curious distinction has persisted for nearly 30 years. Although there have been several efforts to correct this anomaly in the law through changes in the law, none of these legislative efforts has gained much traction in the House or Senate.

BANKRUPTCY ISSUES

Not addressed in the *BC Tile* decision, but another significant issue for individual defendants, is the impact a trust fund claim can have in the context of a personal bankruptcy. Since the MBTFA is predicated on the existence of a trust, a violation of the statute is also a breach of the contractor's fiduciary duties. Under the bankruptcy code, fraudulent conduct while acting in a fiduciary capacity is known as "defalcation," and is one of the specified grounds for excluding a claim from discharge. Said another way, a claim under the MBTFA is a debt that can survive a bankruptcy when most other claims are discharged.

To avoid such long-term personal liabilities, contractors and subcontractors must take care in these turbulent economic times to address shortfalls in payment with subcontractors and suppliers by securing waivers and releases that include officers and shareholders, especially when making compromise payment agreements, and documenting the reasons for non-payment to subcontractors and suppliers where facts and circumstances warrant the withholding of payment. ☞



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Mr. Cavanaugh practices law in Royal Oak. His practice is concentrated on business and construction law matters, including litigation, arbitration, and mediation of contract, construction lien and payment bond claims. He represents contractors, subcontractors, and suppliers. For more information about the Michigan Builder's Trust Fund Act, you can e-mail him at pcavanaugh@cqlawfirm.com or visit his firm online at www.MichiganConstructionLaw.com

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