

Texas Construction Trust Fund Act



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What is the Texas Construction Fund Act?

- ◆ Chapter 162 of the Texas Property Code
- ◆ The Act protects those furnishing labor or materials for the construction or repair of a property by requiring that funds are held in trust for all parties in the construction chain.

Why does the Texas Construction Trust Fund Act exist?

- ◆ Complexity of Construction Jobs
- ◆ Partial Payments throughout the Job
- ◆ General Contractor is only entitled to a small portion of the partial payment that represents the work actually done by the General Contractor, as well as, a markup for overhead and profit
- ◆ Subcontractors need protection

Who is a Trustee Under the Act?

- ◆ A Trustee is a contractor, subcontractor or owner (or any officer, director or agent thereof) who receives trust funds or who has control or direction of trust funds is a trustee.
- ◆ TEX. PROP. CODE § 162.002

Who is a Beneficiary Under the Act?

- ◆ A beneficiary of the trust is a “artisan, laborer, mechanic, contractor, subcontractor, or materialman who labors or who furnishes labor or material for the construction or repair of an improvement on specific real property in this state is a beneficiary of any trust funds paid or received in connection with the improvement.”
- ◆ An Property Owner for a residential construction contract. This includes funds that are deposited into a construction account.

Who is not a Trustee/Beneficiary Under the Act?

- ◆ (1) a bank, savings and loan, or other lender;
- ◆ (2) a title company or other closing agent; or
- ◆ (3) a corporate surety who issues a payment bond covering the contract for the construction or repair of the improvement.

What are Construction Fund Trusts?

- ◆ Construction payments under a construction contract for the improvement of specific real property in this state.
- ◆ Loan receipts if the funds are borrowed for the purpose of improving specific real property in this state, and the loan is secured in whole or in part by a lien on the property.

What is excluded from a Construction Trust?

- ◆ Fees payable to the contractor if:
 - ◆ (1) the contractor and property owner have entered into a written construction contract for the improvement of specific real property in this state before the commencement of construction of the improvement and the contract provides for the payment by the owner of the costs of construction and a reasonable fee specified in the contract payable to the contractor; and
 - ◆ (2) the fee is earned as provided by the contract and paid to the contractor or disbursed from a construction account described by Section 162.006, if applicable.

Residential Homestead Projects

- ◆ Additional Requirements:
 - ◆ A contractor who enters into a written contract with a property owner to construct improvements to a residential homestead for an amount exceeding \$5,000 shall deposit the trust funds in a construction account in a financial institution.
 - ◆ The construction account must be in a financial institution, and the statements from the financial institution must refer to the account as a “construction account.”
 - ◆ Only trust funds can be maintained in this account.

How are Construction Accounts Managed?

- ◆ Contractor must maintain an account of record for the construction account that provides the following information relating to:
 - ◆ (1) the source and amount of the funds in the account and the date the funds were deposited;
 - ◆ (2) the date and amount of each disbursement from the account and the person to whom the funds were disbursed; and
 - ◆ (3) the current balance of the account.

Direct/Indirect Costs

- ◆ The Account of Records must specify the direct and indirect costs:
 - ◆ "Direct cost" means a cost included under a construction contract that is specific to the construction of the improvement that is the subject of the contract.
 - ◆ "Indirect cost" means a cost included under a construction contract that is not specific to the construction of the improvement that is the subject of the contract.

Other Requirements for Management of a Construction Account

- ◆ The contractor shall retain all invoices and other supporting documentation received relating to funds that were disbursed from the construction account.
- ◆ The contractor shall ensure that all deposit and disbursement documentation includes the construction account number or information that provides a direct connection between the documentation and the account.
- ◆ The contractor may not destroy information required to be maintained under this section before the first anniversary of the date the improvement that is the subject of the contract is completed.

What is the Civil Liability is there for Violation of the Texas Construction Trust Act?

- ◆ A trustee who, intentionally or knowingly or with intent to defraud directly or indirectly retains, uses, disburses, or otherwise diverts trust funds without first fully paying all current or past due obligations incurred by the trustee to the beneficiaries of the trust funds, has misapplied the trust funds. TEX. PROP. CODE § 162.031(a).

Individual Liability

- ◆ An owner of a company can be personally liable even if the work was done by a corporation
- ◆ The Act requires that a beneficiary establish that an officer, director, or agent “*directly or indirectly retains, uses, disburses, or otherwise diverts trust funds* without first fully paying all current and past due obligations.” *Direct Value, L.L.C. v. Stock Bldg. Supply, L.L.C.*, 388 S.W.3d 386, 393 (Tex. App.—Amarillo 2012, no pet.)
- ◆ An officer of a company cannot divert liability by asking an employee to sign checks or maintain the records

What qualifies as intent?

A trustee acts with “intent to defraud” when the trustee:

- ◆ a. retains, uses, disburses, or diverts trust funds with the intent to deprive the beneficiaries of the trust funds;
- ◆ b. retains, uses, disburses, or diverts trust funds and fails to establish or maintain a construction account as required by Section 162.006 or fails to establish or maintain an account record for the construction account as required by Section 162.007; or
- ◆ c. uses, disburses, or diverts trust funds that were paid to the trustee reliance on an affidavit furnished by the trustee under Section 53.085 if the affidavit contains false information relating to the trustee’s payment of current or past due obligations.
TEX. PROP. CODE §§ 162.005 (A)-(C).

What type of Criminal Liability is there for Violation of the Trust Act?

- ◆ A trustee who misapplies trust funds amounting to \$500 or more in violation of the Trust Fund Statute commits a Class A Misdemeanor. TEX. PROP. CODE §162.032(a).
- ◆ A trustee who misapplies trust funds amounting to \$500 or more in violation of the Trust Fund Statute, with intent to defraud, commits a felony of the third degree. TEX. PROP. CODE § 162.032(b).
- ◆ Regarding residential construction projects, a trustee who fails to establish or maintain a construction account in violation of the statute or fails to establish or maintain an account record for the construction account in violation of the statute commits a Class A Misdemeanor. TEX. PROP. CODE § 162.032(c).

What are the possible punishments?

- ◆ A Class A Misdemeanor carries a potential fine up to \$4,000 and up to one year in jail. TEX. PROP. CODE § 12.21.
- ◆ A Third Degree Felony carries a potential fine up to \$10,000 and jail confinement for no less than 2 years and no more than 10 years. TEX. PROP. CODE § 12.34.

What Defenses Do You Have?

- ◆ The funds were used to pay actual expenses related to the property
- ◆ If the Trustee has reasonable belief that the beneficiary is not entitled to the funds or the funds have been retained/authorized as required by Chapter 53 of the Texas Property Code.
 - ◆ Notice must be given to maintain this defense.
- ◆ Trustee pays all the funds that a beneficiary is entitled to no later than 30 days following the written notice of a criminal complaint or other notice of a pending criminal investigation

What are actual expenses related to the construction project?

- ◆ There is no definition for this phrase in the Texas Construction Trust Fund Act.
- ◆ Overhead, by definition, includes “expenses of a business, without regard to the outlay on a particular contract,” overhead expenses need not be directly traceable to a particular project but need only reasonably reflect the expenses associated with each project

McElroy v. State, 667 S.W.2d 856, 865 (Tex. App.—Dallas 1984), aff'd, 720 S.W.2d 490 (Tex. Crim. App. 1986)

Can a Lawyer be a Trustee?

- ◆ A Lawyer could be given trust funds by either a project owner or general contractor, which would make the Lawyer a Trustee
- ◆ This could cause a conflict of interest between the Lawyer and the Client, if the Client's instructions are in opposition of the requirements under the Act
- ◆ Withdrawal from representation may not negate the requirements to comply with the Act

Construction Trusts v. Bankruptcy Code

- ◆ Section 523- provides an exception to discharge of any debt incurred for “defalcation while acting in a fiduciary capacity”
- ◆ Courts have varied on the interpretation of this section when applying the Texas Construction Trust Fund Act
- ◆ The burden of proof is on the creditor to disprove a defense that the funds were used for related expenses in the project