PERSONAL LIABILITY UNDER THE CONSTRUCTION TRUST FUND ACT: THE 800 POUND GORILLA YOU NEVER KNEW EXISTED

by Walker M. Duke

Most people in the construction industry in Texas have at least some awareness of the Texas Construction Trust Fund Act. What many contractors may not realize is the potential personal liability that the Trust Fund Act creates. It is very important to be aware of this fact in advance to avoid potentially serious mistakes down the road.

In a nutshell, the Act deems construction payments and loan receipts "trust funds." The corollary is that a "contractor, subcontractor, or owner or an officer, director, or agent of a contractor, subcontractor, or owner, who receives trust funds or who has control or direction of trust funds, is a trustee of the trust funds." What does that mean? It means that the individual owner, officer, director, or agent may personally be a trustee. Trustee status does not simply stop at the corporate veil.

If an individual is a trustee, he or she owes the beneficiary of the trust funds a fiduciary duty. This means a duty of loyalty, and the utmost good faith, candor, integrity of the highest kind, and fair and honest dealing. Fiduciary duties are essentially the highest standards of care in our legal system.

Because the Act confers "trustee status" on individuals and not just companies, personal liability can also fall to the individual–even if they were acting solely in the course and scope of their employment and in furtherance of their employer's business.

In *Herbert v. Greater Gulf Coast Enterprises, Inc.*, 915 S.W.2d 866 (Tex.App.–Houston [1st Dist.] 1995), the Houston Court of Appeals found personal jurisdiction for Trust Fund Act violations over someone who had no individual contact with Texas. In that case, the plaintiff, a subcontractor, sued the Connecticut general contractor and its president individually. The court rejected the defendant's argument that he individually had no contact with Texas. In its ruling, the court noted that the Legislature enacted the Construction Trust Fund Act as a special protection for contractors and subcontractors "to avoid the injustice of owners and contractors refusal to pay for work completed."

The plaintiff in *Kelly v. General Interior Construction*, 262 S.W.3d 79 (Tex.App.–Houston [14th Dist.] July 3, 2008) sued the two sole shareholders of an Arizona general contractor individually for breach of contract, violations of the Construction Trust Fund Act, and fraud. The defendants argued that Texas courts did not have personal jurisdiction over them individually because they acted solely in their corporate capacity. The court ruled that there was no jurisdiction on the breach of contract claim because the individuals had, in fact, acted on behalf of their company. However, they found jurisdiction on the Construction Trust Fund Act claim.

The *Kelly* court noted that the Act essentially allows subcontractors to pierce the corporate veil. The Act creates personal liability if (1) the party breaches the Act's duties with the appropriate intent, and (2) the claimants are within the class of people the Act was designed to protect.

C&G, Inc. d/b/a Fox Rental v. Jones, 165 S.W.3d 450 (Tex.App.–Dallas 2005) is a very interesting case that every contractor and construction lawyer should heed. Fox Rental sued CCG Supply Company, including officers Jones and Duncan under Construction Trust Fund Act. Jones and Duncan had signatory authority on CCG's checking account. Neither of them personally received any trust funds, nor did they "independently" determine to whom the trust funds should be paid. In fact, they simply disbursed such funds as they were directed by the officers of American Eco, which owned CCG. Over time, Jones and Duncan objected to American Eco's use and direction of the funds; in fact, they were eventually asked to leave their employment in large part because of their objections to the way American Eco handled the funds. By all accounts, these guys were doing the "right thing" and objecting.

Nevertheless, court of appeals held that they participated in both the decision to divert the funds and the actual diversion of the funds. As such, they were held personally liable. Their objections were not a defense, and the court also did not accept the "just following instructions" justification either.

The point of this analysis is that construction trust funds are a serious matter that can bring serious personal liability. There are defenses to claims of violations of the Act, but with the potential for personal liability, these defenses should be particularly well documented. In any event, construction trust funds are not something to play fast and loose with. Knowing the Act's requirements and potential for liability in advance will, however, help minimize liability down the road.

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