

# Contractors’ Civil Liability Under Colorado’s Mechanics’ Lien Trust Fund Statute

BY LAURA MARTINEZ



*This article provides an overview of Colorado's mechanics' lien trust fund statute and discusses civil liability that may arise if a contractor violates the statute.*

**U**nder Colorado's mechanics' lien trust fund statute, CRS § 38-22-127 (trust fund statute or statute), a contractor who fails to pay its subcontractors, despite having been paid by the owner, can face criminal and civil liability. This article provides an overview of civil liability under the trust fund statute.

A contractor can face significant civil liability for violating the statute, including treble damages and reasonable attorney fees (in addition to costs and interest generally recoverable). In addition, corporate representatives could be personally liable if they personally participated in failing to pay subcontractors the funds received from a property owner. Further, civil liabilities incurred pursuant to the trust fund statute may be non-dischargeable in bankruptcy. As a result, property owners facing mechanics' liens and subcontractors who have not been paid often use the statute's strong mechanism.

### **The Trust Fund Statute: Overview**

The trust fund statute requires that all funds disbursed to a contractor or subcontractor on any construction project be held in trust for the payment of subcontractors, laborers, or material suppliers.<sup>1</sup> Although the statute requires each contractor to maintain separate accounting records for each project or contract, it does not require the contractor to maintain a separate bank account for each project.<sup>2</sup> To recover under the statute, a claimant is not required to have a properly perfected lien, or to still be able to perfect a lien.<sup>3</sup> However, the statute does not apply if the contractor who received the disbursement posts a bond, or if the property owner has executed a written release.<sup>4</sup>

The Colorado Supreme Court described the legislative intent in enacting the statute as follows:

Although this provision provides assurances of payment to subcontractors, laborers, and

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suppliers, the general assembly's "primary concern" in enacting it was "the protection of property owners against unscrupulous contractors." The trust obligation protects owners from having to pay for labor or materials twice in an effort to avoid mechanics' liens if a dishonest contractor

collects an initial payment from the owner but fails to pay a subcontractor, laborer, or supplier, thereby leaving the owner with little choice other than to make a second payment directly to the unpaid potential lienholder. Section 38-22-127(1) effectuates this purpose by requiring contractors and subcontractors to hold certain funds in trust for the payment of subcontractors, laborers, and suppliers—namely, all funds "disbursed to any contractor or subcontractor under any building, construction, or remodeling contract or on any construction project."<sup>5</sup>

Moreover, the statute explicitly provides that a violation of the statute constitutes theft as defined in CRS § 18-4-401.<sup>6</sup>

### **Liability for Civil Theft**

Violation of the trust fund statute could result in liability for treble damages and attorney fees because of the statute's explicit tie to civil theft under CRS § 18-4-401.<sup>7</sup> Recovery of treble damages and attorney fees is not automatic; rather, a claimant must prove that the contractor committed acts constituting the statutory crime of theft.<sup>8</sup> If all elements of civil theft have been proven by a preponderance of the evidence, the trial court lacks discretion to decline to award treble damages.<sup>9</sup> Someone commits civil theft if they knowingly obtain, retain, or exercise control over anything of value of another without authorization or by threat or deception; receive, loan money by pawn or pledge on, or dispose of anything of value or belonging to another that they know or believe to have been stolen; and

- (1) intend to deprive the other person permanently of the use or benefit of the thing of value;
- (2) knowingly use, conceal, or abandon the thing of value in such manner as to deprive the other person permanently of its use or benefit;

- (3) use, conceal, or abandon the thing of value intending that such use, concealment, or abandonment will deprive the other person permanently of its use or benefit;
- (4) demand any consideration to which they are not legally entitled as a condition of restoring the thing of value to the other person;
- (5) knowingly retain the thing of value more than 72 hours after the agreed-upon time of return in any lease or hire agreement; or
- (6) intentionally misrepresent or withhold a material fact for determining eligibility for a public benefit and does so for the purpose of obtaining or retaining public benefits for which the person is not eligible.<sup>10</sup>

The intent element of “knowingly” does not require a conscious objective to deprive another person of the use or benefit of the construction trust funds, but instead requires the offender to be aware that his manner of using the trust funds is practically certain to result in depriving another person of the use or benefit of the funds.<sup>11</sup>

In *In re Helmke*, the defendants argued that because they “honestly hoped and desired to save their business and pay its creditors” (including plaintiff), “they could not have committed civil theft.”<sup>12</sup> However, the US Bankruptcy Court for the District of Colorado held that this subjective hope did not negate its finding that the defendants knowingly used funds held in trust under the trust fund statute in a manner practically certain to deprive the plaintiff of the use and benefit of those funds. The court explained:

If the property held in trust for Plaintiff by Defendants was a chattel, rather than a monetary fund, this analysis would be more obvious. Defendants could not claim they did not commit theft if they knowingly took a car held in trust for Plaintiff and sold it without authorization, even though it was their honest hope and intent to eventually replace the car.<sup>13</sup>

Therefore, liability for civil theft (and the attorney fees and treble damages recoveries

that accompany it) is a significant likelihood when a trust fund statute violation has been established.

### Personal Liability for Corporate Actors

Colorado has long recognized that corporate officers and directors may be held personally liable for illegal acts of a corporation in which they actively participated.<sup>14</sup> Consequently, many courts have held officers, directors, and managers of a corporation personally liable for violations of the trust fund statute.<sup>15</sup> In fact, select courts have not limited personal liability to “officers, directors, or managers”; rather, potential liability is far broader and may be applied to any “individual in complete control of the finances and financial decisions of an entity which violated the trust fund statute.”<sup>16</sup>

### Non-Dischargeability in Bankruptcy

Damages owed under the trust fund statute may be deemed non-dischargeable in bankruptcy—for both the corporation and the individual.<sup>17</sup> This is one of many aspects of the trust fund statute that makes it a particularly powerful tool for owners who have liens recorded on their properties and for subcontractors and materials suppliers who have not been paid.

In *In re Barnes*, four adversary actions filed by unpaid suppliers of material and/or labor used for the construction of a single-family residence were consolidated.<sup>18</sup> Plaintiffs asserted that their debts against the debtor, the sole member and manager of the developer and general contractor entities used to construct the residence, were non-dischargeable pursuant to 11 USC § 523(a)(4) as a result of debtor’s defalcation while acting in a fiduciary capacity. The court stated that a creditor seeking to except a debt from discharge under 11 USC § 523(a)(4) must establish: “(1) that a fiduciary relationship existed between the debtor and the creditor, and (2) that the debt owed to the creditor is attributable to the fraud or

defalcation committed by the debtor in the course of the fiduciary relationship.”<sup>19</sup>

The court held that the first element had been met as the trust fund statute creates an express trust sufficient to establish a fiduciary relationship under § 523(a)(4). The court held that the second element had been met as it was established that the debtor’s company could not account for construction loan funds it received for the property, and funds received were not used to pay the claims of the plaintiffs (and other beneficiaries under the trust) but instead were used to satisfy the debtor’s other obligations. Significantly, the court held that “defalcation committed in the course of a fiduciary relationship does not require any deliberate wrong-doing or element of intent or bad faith. Negligence or the failure of a fiduciary to account for money or property entrusted to him is sufficient to establish a defalcation.”<sup>20</sup>

### Conclusion

Considering the significant civil damages that can be awarded for a violation of the trust fund statute—for both the entity and its representatives—and the fact that those damages may be non-dischargeable in bankruptcy, it is imperative that companies create and strictly follow procedures to ensure compliance with the trust fund statute.

First, companies must remember the principle behind the trust fund statute—that the funds received for a project are held in a trust for the payment of contractors, subcontractors, and suppliers. With this general theme in mind, a construction attorney should advise their clients to maintain separate financial records for each project, promptly pay subcontractors and suppliers from the project funds, and not commingle project funds with general business or personal funds. These steps are critical and should be followed by all construction companies to avoid civil liability under the trust fund statute. CL



**Laura Martinez** is a director at Fairfield & Woods P.C. in Denver. She practices civil litigation, with a focus on construction law and commercial litigation—lmartinez@fwlaw.com.

**Coordinating Editor:** Leslie A. Tuft, ltuft@torbetlaw.com

## NOTES

1. CRS § 38-22-127(1).
2. CRS § 38-22-127(4).
3. *In re Regan*, 151 P.3d 1281, 1289 (Colo. 2007), as modified on denial of reh'g (Feb. 26, 2007).
4. CRS § 38-22-127(2)–(3).
5. *Yale v. AC Excavating, Inc.*, 295 P.3d 470, 475 (Colo. 2013) (internal citations omitted).
6. CRS § 38-22-127(5).
7. CRS § 18-4-405 provides: “All property obtained by theft, robbery, or burglary shall be restored to the owner, and no sale, whether in good faith on the part of the purchaser or not, shall divest the owner of his right to such property. The owner may maintain an action not only against the taker thereof but also against any person in whose possession he finds the property. In any such action, the owner may recover two hundred dollars or three times the amount of the actual damages sustained by him, whichever is greater, and may also recover costs of the action and reasonable attorney fees; but monetary damages and attorney fees shall not be recoverable from a good-faith purchaser or good-faith holder of the property.” (Emphasis added.)
8. *In re Est. of Chavez*, 520 P.3d 194, 205 (Colo. App. 2022) (internal citations omitted), as modified on denial of reh'g (Aug. 25, 2022).
9. *Id.*
10. CRS § 18-4-401. See also *People v. Anderson*, 773 P.2d 542, 545 (Colo. 1989) (“[P]ursuant to section 18-4-401(1)(b), the crime of theft

may be committed when the offender knowingly obtains control over the property of another without authorization and, even though not intending to deprive the other person permanently of the use or benefit of the property, nonetheless knowingly uses the property in such manner as to deprive the other person permanently of the use or benefit of the property.”).

11. *Anderson*, 773 P.2d at 545.
12. *In re Helmke*, 398 B.R. 38, 40 (Bankr.D.Colo. 2008).
13. *Id.* at 40, 41 n.2.
14. *Q.E.R., Inc. v. Hickerson*, 880 F.2d 1178, 1182–83 (10th Cir. 1989) (citing *Klockner v. Keser*, 488 P.2d 1135, 1137 (Colo.App. 1971)).
15. See, e.g., *Alexander Co. v. Packard*, 754 P.2d 780, 782 (Colo.App. 1988) (imposing personal liability on corporate officers who personally participated in construction trust fund statute violation); *Flooring Design Assocs. v. Novick*, 923 P.2d 216, 221 (Colo. App. 1995) (chief financial officer who had personally participated in the trust fund violation was personally liable for trust fund violation); *AC Excavating, Inc. v. Yale*, 297 P.3d 937, 941 (Colo.App. 2010) (noting managers’ potential liability for violation of trust fund statute), *rev’d on other grounds*, 295 P.3d 470 (Colo. 2013); *Q.E.R., Inc.*, 880 F.2d at 1182–83 (noting Colorado has recognized the rule that corporate officers and directors may be held personally liable for illegal corporate acts in which they actively participated); *In re*

*Walker*, 315 B.R. 595, 598–99 (Bankr.D.Colo. 2004) (Colorado’s trust fund statute “has been interpreted for many years by Colorado courts to hold accountable officers of a corporate contractor or subcontractor who have controlled the entity’s finances and actually engaged in conduct constituting the statutory breach of trust”), *aff’d in relevant part*, 325 B.R. 598, 601–02 (D.Colo. 2005); *In re Gamboa*, 400 B.R. 784, 792 (Bankr.D.Colo. 2008) (entity’s president and officer in charge of entity’s finances personally liable for any breach of trust fund statute), *abrogated on other grounds as recognized in In re Cupit*, 415 B.R. 42, 56 (Bankr.D.Colo. 2014); *In re Regan*, 311 B.R. 271, 281 (Bankr.D.Colo. 2004) (sole shareholders, officers, and directors of entity having personally participated in trust fund violation held personally liable), *aff’d*, No. 04-CV-01483, 2007 WL 1346576 (D.Colo. May 4, 2007); *In re Barnes*, 377 B.R. 289, 298 (Bankr.D.Colo. 2007) (individuals in complete control of the finances and financial decisions of an entity that violated the trust fund statute are personally liable for such violation).

16. *In re Barnes*, 377 B.R. at 298.
17. See, e.g., *id.* (chapter 7 debtor’s personal liability under the trust fund statute was non-dischargeable in bankruptcy as debt for debtor’s “defalcation” while acting in “fiduciary capacity”).
18. *Id.* at 292–98.
19. *Id.* at 296.
20. *Id.* at 297.

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