

Colorado's Mechanics' Lien Trust Fund Statute: Robbing Peter to pay Paul might land you in jail

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Is your general contracting firm compliant with Colorado's Mechanics' Lien Trust Fund Statute? Do you even know what the Mechanics' Lien Trust Fund Statute is? You cannot afford to not know.

Many general contractors believe they just need to pay their invoices before a lien is filed on a project to protect themselves from claims of improper handling of payments to subs and suppliers. Yet the legal requirements on accounting and funds handling procedures go much farther than that. Failure to comply with the statute can lead to severe consequences — to the firm and its employees.

In effect since 1975, the Mechanics' Lien Trust Fund Statute mandates that all funds disbursed to a contractor must be held in trust for payment to subcontractors and suppliers on that project. The contractor cannot use those funds for any other use. When a contractor receives payment for a project, those funds must be held and used for the benefit of subs and material suppliers. What's more, a general contractor must maintain a separate, detailed accounting record for each project or contract that tracks the monies received and paid.

Lawsuits for violations of this statute can be filed by subs, suppliers or property owners and can even be filed as part of another legal proceeding, such as construction defect action.

Naturally, a general contractor can get slapped with some very severe penalties when failing to adhere to the statute's requirements. While seemingly unfair, especially if assessed in any combination, the fact remains that the following are the law:

Personal liability

The officer or other employee of the general contractor who is found to have mishandled subcontractor funds can be personally liable for the damages awarded to the claimant subcontractor or property owner. This might include personal liability for any missed or late payments, any treble damages awarded, and any attorneys' fees and costs awarded.

Criminal penalties

Any person who violates the statute commits a criminal theft, and can be prosecuted by the District Attorney. It's a misdemeanor if the funds in question total less than \$1,000, however, if they're more, the violation becomes a felony. If convicted of a felony, the violator or the company can be fined anywhere between \$2,000 and \$750,000, jailed from two to 12 years, and face three to five years of mandatory parole.

Treble damages

If a jury finds that the statute was violated fraudulently, maliciously, willfully, and/or wantonly, the judge can award the claimant up to three times the actual damages as punitive damages. This is addition to the actual damages awarded.

Attorney's fees

A violation of the statute is considered a breach of a fiduciary duty. As a result, if found liable under the statute, the violator may have to pay attorney's fees of the claimant.

Litigation costs

The prevailing party can recover litigation costs, including filing fees, expert witness costs, copying costs, and other miscellaneous expenses.

Not protected by bankruptcy

When a judgment is entered against a company or individual for violation of the statute, it cannot be discharged in any bankruptcy proceeding. Since the law deems the judgment to be the result of fraud or other misconduct, the judgment debt will stay with the company or individual forever, or until paid, with interest accruing and compounding annually.

There are situations where complying with the record keeping and fund handling requirements of the statute aren't necessary. These include when the subcontractor has furnished a performance or payment bond for the project, and when the owner of the property has executed a written release or waiver. If you think your company or project falls into one of the exceptions, talk with an attorney to make sure.

You may also wish to check with an attorney about whether your accounting system is adequate to satisfy the statute's requirements. Given the potentially harsh consequences for failure to comply with the statute, proper accounting and handling of project funds should be one of your first new year's resolutions.

The full text of the Mechanics' Lien Trust Fund Statute, Colorado Revised Statute § 38-22-127, can be found online at: <http://198.187.128.12/colorado/lpext.dll?f=templates&fn=fs-main.htm&2.0>

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