

CONTRACTOR ALERT

Contractor Alert is a joint publication by this Contractor and the Law Offices of Richard M. Sissman, Esquire, located at 1485 Chain Bridge Road, Suite 105, McLean, VA 22101. This newsletter is designed to give general information on the matters covered. Space limitation prevents exhaustive treatment or analysis of this topic. This newsletter is not intended to substitute for advice on specific legal problems. If you are interested in receiving a complimentary issue or to be placed on our mailing list, contact Richard M. Sissman, Esquire. We welcome and appreciate your suggestions for future article topics.

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MARYLAND LENDERS WILL BE HELD LIABLE UNDER CONSTRUCTION TRUST STATUTE

Construction industry lenders can be held liable under a trust statute designed to protect subcontractors from dishonest contractors, the Court of Special Appeals has held.

In a decision issued last week, the state's intermediate appellate court said that although accounts-receivable lenders are not subcontractors under the Construction Trust Statute, such lenders could be held liable as involuntary trustees of money that is meant to pay subcontractors for their work on a construction project.

"It keeps lenders on their toes and in line so as not to disrupt the flow of trust funds," said Kenneth K. Sorteberg, an attorney involved in the case. "If a lender sticks its cup into that flow of funds ... they have to make sure the subcontractors downstream have been paid."

In the case before the Court, Presidential Financial Corporation of the Chesapeake lent money to Power, Alarm and Communications, Inc., which used its accounts receivable to secure the loan.

Power, Alarm and communications, or PACS, was a subcontractor to Phillips Way Inc. on public construction projects at Crofton elementary School and Baltimore City Community College. PACS also entered into subcontracts of its own with companies that supplied both work and material for the projects.

Phillips Way paid about \$84,000 for work done by PACS and its subcontractors through checks made payable to PACS and Presidential Financial. According to the court, PACS transferred the checks to Presidential to pay creditors other than PACS' subcontractors on the construction projects.

After PACS went out of business without paying its subcontractors, Phillips Way sued Presidential under the Construction Trust Statute to recover its money. That suit was dismissed and Phillips Way appealed.

The Court of Special Appeals last week reversed the lower court, finding that Presidential knew the funds it received from PACS were trust funds meant to pay the subcontractors for their work on the projects.

"An accounts receivable lender who receives money directly from a general contractor as payment for work performed by its borrower-

subcontractor can easily take steps to affirm that the down-the-line subcontractors retained by the borrower-subcontractor have been paid," Judge Sally D. Adkins wrote for the appeals court, rejecting Presidential's claim that it should not have to monitor the business operations of its borrowers.

"It's not a big deal for a lender to make sure the folks downstream have been paid," said Sorteberg, who represented Phillips Way.

If the lender fails to take such steps and knows that the monies it has received from its borrower were trust funds meant to pay other subcontractors, it becomes liable as an involuntary trustee under the statute, the court said.

"For us to allow a subcontractor to escape the requirements of the Construction Trust Statute --- merely by directing payment of its accounts receivable to its lender would permit --- and perhaps invite --- lenders and borrowers --- subcontractors to 'write checks around' the statute," Adkins wrote.

If you should have any questions on this issue please contact Mr. Sissman at his website at www.contractoralert.com or by phone at (703) 903-9646 or (301) 762-0402.