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THE MARYLAND CONSTRUCTION TRUST STATUTE: NEW PERSONAL LIABILITY—ITS SCOPE AND FEDERAL BANKRUPTCY IMPLICATIONS

David F. Albright, Jr.†

I. INTRODUCTION

In 1987, the Maryland General Assembly enacted a new statute entitled "Trust Relationships in the Construction Industry"¹ (the "construction trust statute"), codified in sections 9-201 through 9-204 of the Real Property article of the Maryland Annotated Code.² This new statute, located immediately after the subtitle entitled "Mechanics' Liens" (the "mechanics' lien statute"),³ is designed to complement the latter and to reinforce the rights and responsibilities of contractors and subcontractors in the construction industry. To implement these objectives, the construction trust statute designates monies received by a contractor or a subcontractor on a construction project as trust funds for the payment of sums due to lower-tiered subcontractors.⁴

As with any new statute, a number of questions arise concerning the interpretation and effect of the construction trust statute. Perhaps the most important of these questions involves the personal liability of officers, directors, and employees of contractors and subcontractors. First, this article reviews the Maryland mechanics' lien statute as well as analyzes the content and history of the construction trust statute. Next, it examines the circumstances in which officers, directors, and employees of contractors and subcontractors may be held personally liable under the construction trust statute. Finally, this article discusses whether officers, directors, and employees who are found personally liable under the construction trust statute will be able to obtain a discharge of their debts by filing bankruptcy.

II. CONTENT AND HISTORY OF THE MARYLAND CONSTRUCTION TRUST STATUTE

A. *The Mechanics' Lien Statute*

A review of the mechanics' lien statute will facilitate comprehension of the purpose and operation of the construction trust statute. Although the mechanics' lien statute provides contractors and subcontractors with an effective means of collecting sums due and owing from owners and

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1. 1987 Md. Laws 345.

2. MD. REAL PROP. CODE ANN. §§ 9-201 to -204 (1988) (effective July 1, 1987).

3. *Id.* §§ 9-101 to -114.

4. *Id.* § 9-201.

contractors on a construction project, it fails to impose liability directly on the individuals who are responsible for causing the problem.

The mechanics' lien statute enables unpaid contractors⁵ and subcontractors⁶ to assert a lien against the property for which they provided labor and/or materials.⁷ Except where single family dwellings are involved,⁸ the statute imposes no limitation upon the maximum amount which a contractor or subcontractor may claim.⁹

When a property owner receives notice from a subcontractor of intent to claim a mechanics' lien, the owner is entitled to withhold from the contractor who employed the subcontractor, the amount that the owner ascertains is due all subcontractors of that contractor.¹⁰ If, however, the amount of all subcontractor liens asserted against the property exceeds the balance due the contractor, section 9-104(f) of the Maryland Real Property Code provides no protection to the property owner. The owner is entitled to indemnification from the contractor for all subcontractors' liens that the owner is required to pay,¹¹ but this right of indemnity may be worthless if the contractor is insolvent. Because the term "subcontractor" is so broadly defined under the mechanics' lien statute,¹² the owner's property may be subject to liens from lower-tiered suppliers, sub-subcontractors, and even laborers. The total may be many times greater than the amount withheld from the contractor. Similarly, a solvent contractor who has contractually agreed to indemnify the owner from claims of lower-tiered subcontractors and suppliers may encounter the same problem if one of his subcontractors becomes insolvent.

5. A "contractor" is any person who has a contract with an owner. *Id.* § 9-101(d).

6. Under the mechanics' lien statute, a "subcontractor" is any person who has a contract with anyone except the owner or his agent. *Id.* § 9-101(g). The court of appeals has not limited who may assert a mechanics' lien based upon where the claimant stands in the contract chain. *National Elec. Indus. Fund v. Bethlehem Steel Corp.*, 296 Md. 541, 547-48, 463 A.2d 858, 861 (1983) (individual employees of subcontractor entitled to claim mechanic's lien); *Diener v. Cabbage*, 259 Md. 555, 563, 270 A.2d 471, 475-76 (1970) (labor and material sub-subcontractors may claim mechanics' lien). Further, the claimant need not be in contractual privity with the owner of the property. MD. REAL PROP. CODE ANN. § 9-105 (1988); *Sodini v. Winter*, 32 Md. 130 (1870).

7. MD. REAL PROP. CODE ANN. § 9-102(a) (1988).

8. Section 9-104(f)(3) provides:

Notwithstanding any other provision of this section to the contrary, the lien of the subcontractor against a single family dwelling being erected on the land of the owner for his own residence shall not exceed the amount by which the owner is indebted under the contract at the time the notice is given.

MD. REAL PROP. CODE ANN. § 9-104(f)(3) (1988).

9. The Maryland mechanics' lien statute is different in this respect from other states' statutes which permit a subcontractor to assert a lien only to the extent of the amount due and owing from the owner to the contractor. *See, e.g.*, D.C. CODE ANN. § 38-104 (1981); VA. CODE ANN. § 43-7 (1986).

10. MD. REAL PROP. CODE ANN. § 9-104(f) (1988).

11. 74 AM. JUR. 2D *Suretyship* § 171 (1974); A. STEARNS, *THE LAW OF SURETYSHIP* § 11.8 (5th ed. 1951).

12. *See supra* note 6.

B. *Legislative History of the Construction Trust Statute*

The legislative history of the Maryland construction trust statute indicates concern in the construction industry about subcontractors who fail to pay their bills, close their doors, and then reopen for business under a new name.¹³ Prior to the enactment of the Maryland construction trust statute, Maryland corporate law protected individual officers, directors, and employees from debts of the corporation, thereby allowing an individual engaged in the construction business to avoid personal liability for the corporation's debts in most circumstances.¹⁴ Thus, an unscrupulous individual could establish a thinly capitalized construction company, use funds from a project to pay handsome salaries to the company's officers, and be fairly confident that the officers would not be personally responsible for the debts of lower-tiered subcontractors and suppliers.

An obvious deterrent to a recalcitrant contractor or subcontractor, who, by nonpayment of lower-tiered subcontractors, allows mechanics' lien claims to be asserted, is the imposition of some personal penalty upon the officers, directors, or employees of the unscrupulous company. A number of states have imposed criminal sanctions upon individuals whose companies fail to pay lower-tiered subcontractors out of funds received on a construction project.¹⁵ Other states have created civil remedies against the officers of a defaulting company.¹⁶

When the Maryland Senate initially addressed this problem, it sought to establish both criminal sanctions and civil liability.¹⁷ As originally drafted, the senate bill designated monies received by a contractor or a subcontractor on a construction project as trust funds for the payment of sums due to lower-tiered subcontractors.¹⁸ Any officer, director, or employee of the contractor or subcontractor who, with intent to defraud, retained or used the monies held in trust for any purpose other than to pay lower-tiered subcontractors was guilty of larceny, and was

13. A major subcontractor's financial failure precipitates a chain reaction due to the accumulation of unpaid monies to their subcontractors and suppliers that must be repaid by the owner or general contractor to free the project from mechanics' liens.

Virtually every major construction project sees a subcontractor fail financially. To the extent that the retainage is inadequate to cover the unpaid subcontractors and suppliers of the failed subcontractor for work performed, the general contractor or owner must make up that difference. Usually the failed subcontractor simply reopens business under a new name and continues to plague our industry. Letter from Phillip W. Worrall to the Hon. Walter M. Baker (Mar. 10, 1987).

14. See e.g., *Ace Development Co. v. Harrison*, 196 Md. 357, 366, 76 A.2d 566, 570 (1950) (absent fraud, corporate agent not personally liable on corporate contract).

15. For an excellent discussion of state court decisions imposing criminal sanctions, see Annotation, *Validity and Construction of Statute Providing Criminal Penalties for Failure of Contractor who has Received Payment from Owner to Pay Laborers or Materialmen*, 78 A.L.R.3d 563 (1977).

16. See, e.g., OKLA. STAT. ANN. tit. 42, §§ 152, 153 (West 1979 & Supp. 1988).

17. 1987 Md. Laws 1932 (Senate Bill 374).

18. *Id.* § 9-115, 1987 Md. Laws 1932.

subject to a maximum fine not to exceed \$5,000, and imprisonment of not more than one year.¹⁹ In addition to criminal sanctions, the original senate bill would have imposed civil personal liability upon any officer, director, or employee of any contractor or subcontractor for these actions.²⁰

The enacted version of the Maryland construction trust statute is similar to the senate bill with one important exception. The statute retains the personal liability provision but deletes the criminal sanctions.²¹ The statute creates an express trust consisting of monies received by a contractor or subcontractor on a construction project.²² Despite the creation of the express trust, the statute does not require the contractor or subcontractor to place the funds in a separate account.²³ Additionally, the statute requires proof of "intent to defraud" to impose personal liability on officers, directors, and employees.²⁴ Mere use of the trust funds for any purpose other than payment of subcontractors, however, constitutes *prima facie* evidence of the required intent.²⁵ The statute applies to both private and public construction projects,²⁶ but not to contracts for the construction and sale of a single family residential dwelling,²⁷ or home improvement contracts by licensed home improvement contractors.²⁸

III. PERSONAL LIABILITY OF OFFICERS, DIRECTORS, AND EMPLOYEES

A. *Language in the Construction Trust Statute*

The primary issue under the Maryland construction trust statute is determining which circumstances will result in personal liability for officers, directors, and employees. Because there are no Maryland decisions interpreting the statute, resolution of this issue requires an analysis of the statutory language as well as a review of relevant decisions from other states.

The scope of the statutory language is broad. "Any officer, director, or employee" is subject to personal liability.²⁹ Although officers, directors, and employees of a contractor or subcontractor are not liable under section 9-202 of the Real Property Code solely on account of their status, the activities which subject them to personal liability are broad. Any person defined in the statute who "retains or uses" trust funds for any pur-

19. *Id.* § 9-116(b), 1987 Md. Laws 1933.

20. *Id.* § 9-118, 1987 Md. Laws 1933-34..

21. MD. REAL PROP. CODE ANN. § 9-202 (1988).

22. *Id.* § 9-201(a).

23. *Id.* § 9-201(b).

24. *Id.* § 9-202.

25. *Id.* § 9-203.

26. *Id.* § 9-204(a).

27. *Id.* § 9-204(b)(1).

28. *Id.* § 9-204(b)(2).

29. *Id.* § 9-202.

pose other than to pay lower-tiered subcontractors, "with intent to defraud," is personally liable to any person damaged by the action.³⁰ The phrase "retains or uses" raises a number of questions concerning the type of involvement which will result in personal liability. Certainly some officers, directors, or employees such as the comptroller or project manager will have direct involvement or control over the use of trust funds. Others, while not directly involved in the use or retention of trust funds, may nevertheless be sufficiently involved in the day-to-day operations of the company to also be subject to personal liability. Furthermore, the issue will arise whether an individual with knowledge of the diversion of trust funds, but with no direct role in either the daily operation of the company or the diversion of trust funds, will be personally liable.

The "intent to defraud" requirement is closely related to the analysis of what type of involvement in the diversion of trust funds is necessary to subject an officer, director, or employee to personal liability. Although the "intent to defraud" language appears to restrict the scope of personal liability, the statute provides that the use of trust funds for any purpose other than to pay lower-tiered subcontractors is "prima facie evidence of intent to defraud."³¹ Accordingly, proof of diversion of trust funds will enable the plaintiff to survive a motion for judgment on this issue.

B. *Judicial Construction of Similar Maryland Statutes*

Presently, the breadth to which the Maryland courts will construe personal liability under the construction trust statute is unclear. Nevertheless, *Comptroller v. House*,³² a decision of the court of special appeals under a similar statute, suggests that the courts will broadly interpret the personal liability provision of section 9-202 of the Real Property Code.

Comptroller v. House involved the interpretation of section 312(h)(4) of Article 81 of the Maryland Annotated Code, which imposes personal liability on an officer of a corporation "who exercises direct control over the fiscal management of the corporation," in the event that the corporation fails to withhold tax from employee wages.³³ One issue in that case was whether an individual (House), who was the corporation's majority

30. *Id.*

31. *Id.* § 9-203.

32. 68 Md. App. 560, 514 A.2d 496 (1986).

33. Section 312(h)(4) provided as follows:

Any employer who negligently shall fail either to withhold the required tax or to pay it to the Comptroller as specified, or both, shall be held personally and individually liable for all monies so involved, and if the employer is a corporate entity, the personal liability shall extend and be applicable to (1) any officer of the corporation who exercises direct control over the fiscal management of the corporation and (2) any agent of the corporation who, in his capacity as such, is under a duty to withhold the tax and transmit to the Comptroller. Any sum or sums withheld in accordance with the provisions of this section shall be deemed to be held by the employer in trust for the State of Maryland and by such employer

shareholder, a director, and chairman of the board, was also an officer who exercised "direct control over the fiscal management of the corporation."³⁴ Another individual was responsible for the day-to-day operation of the corporation, although House on occasion had participated in business decisions.³⁵ The Maryland Tax Court found that House was liable for the taxes;³⁶ the Baltimore City Circuit Court subsequently reversed the tax court.³⁷

The court of special appeals agreed with the tax court, holding that the circuit court's construction of the term "direct control" as meaning day-to-day control was "inordinately narrow and contravenes the intent of art. 81, § 312(h)(4)."³⁸ Since House advised the president of the corporation of potential business opportunities and risks, involved himself in the acquisition of a piece of equipment essential to the corporation's business, and played a significant role in attempting to extricate the corporation from its financial problems, House exercised "direct control" and was personally liable under section 312(h)(4).³⁹

The importance of *Comptroller v. House* in construing the Maryland construction trust statute is revealed by comparison of the language of the construction trust statute with the language of article 81, section 312(h)(4) of the Maryland Annotated Code. Both statutes create trusts and personal liability of corporate officers who violate the trusts.⁴⁰ The court's decision not to give an "inordinately narrow"⁴¹ construction to section 312(h)(4) suggests that the court would not give a narrow construction to the personal liability provision of the construction trust statute.

A review of decisions in other jurisdictions with statutes similar to the Maryland construction trust statute may be instructive in assessing which circumstances will produce personal liability in Maryland. Execution of certain standard documents used in the construction industry may prove actual participation in the diversion of trust funds. For example, on most construction projects a contractor will submit to the owner "Applications and Certificates for Payment." In *Au Bon Pain Corp. v. Arctect, Inc.*,⁴² an officer's execution of these forms on a project was sufficient to prove personal liability under the Michigan construction trust

recorded in a ledger account so as clearly to indicate the amount of tax withheld and that such amount is the property of the State of Maryland.

MD. ANN. CODE art. 81, § 312(h)(4) (1980).

34. *House*, 68 Md. App. at 562, 514 A.2d at 497.

35. *Id.* at 563-64, 514 A.2d at 498.

36. *Id.* at 565, 514 A.2d at 499.

37. *Id.* at 567, 514 A.2d at 499.

38. *Id.* at 568, 514 A.2d at 500.

39. *Id.*

40. *Compare* MD. ANN. CODE, art. 81, § 312(h)(4) (1980) with MD. REAL PROP. CODE ANN. §§ 9-201, 9-202 (1988).

41. *House*, 68 Md. App. at 568, 514 A.2d at 500.

42. 653 F.2d 61 (2d Cir. 1981).

statute.⁴³

In *Au Bon Pain Corp.*, the plaintiff, an owner/operator of a chain of retail bake shops, had hired an architectural firm to design several bake shops and a contracting company to build the facilities. The two individual defendants in the action were partners in the architectural firm and also officers of the contracting company. During the course of construction the owner paid the contracting company substantial sums, but the contracting company failed to pay various subcontractors. After the owner satisfied subcontractor claims, the owner sued the contracting company and the two officers for the amounts paid to discharge the subcontractor claims.⁴⁴

At trial, the owner introduced into evidence "Applications and Certificates for Payment" signed by an officer on behalf of the contracting company.⁴⁵ The owner argued that under the Michigan construction trust statute, the officer was personally liable for diversion of funds held in trust by the contractor for amounts due subcontractors.⁴⁶ The district court held that the owner had failed to establish its *prima facie* case and dismissed the action.⁴⁷ The Court of Appeals for the Second Circuit re-

43. Michigan law on the subject provides:

570.151 Building contract fund; status as a trust fund

Sec. 1. In the building construction industry, the building contract fund paid by any person to a contractor, or by such person or contractor to a subcontractor, shall be considered by this act to be a trust fund, for the benefit of the person making the payment, contractors, laborers, subcontractors or materialmen, and the contractor or subcontractor shall be considered the trustee of all funds so paid to him for building construction purposes.

570.152 Same; fraudulent detention or use by contractor or subcontractor, penalty

Sec. 2. Any contractor or subcontractor engaged in the building construction business, who, with intent to defraud, shall retain or use the proceeds or any part thereof, of any payment made to him, for any other purpose than to first pay laborers, subcontractors and materialmen, engaged by him to perform labor or furnish material for the specific improvement, shall be guilty of felony in appropriating such funds to his own use while any amount for which he may be liable or become liable under the terms of his contract for such labor or material remains unpaid, and may be prosecuted upon the complaint of any persons so defrauded, and, upon conviction, shall be punished by a fine of not less than 100 dollars or more than 5,000 dollars and/or not less than 6 months nor more than 3 years imprisonment in a state prison at the discretion of the court.

570.153 Same; evidence of fraudulent detention or use

Sec. 3. The appropriation by a contractor, or any subcontractor, of any monies paid to him for building operations before the payment by him of all monies due or so to become due laborers, subcontractors, materialmen or others entitled to payment, shall be evidence of intent to defraud.

MICH. COMP. LAWS ANN. §§ 570.151 - 570.153 (West 1967).

44. *Au Bon Pain Corp.*, 653 F.2d at 63.

45. *Id.*

46. *Id.* at 64.

47. *Id.* at 65.

versed, holding that the officer's signature on the "Applications and Certificates for Payment" was sufficient to produce personal liability under the Michigan construction trust statute.⁴⁸

The Michigan statute has the same "retain or use" language which triggers personal liability under the Maryland statute. If Maryland courts follow the Michigan approach, the execution of "Applications and Certificates for Payment" may be construed to subject an individual to personal liability in Maryland.

New York courts have also addressed the issue of personal liability under the New York construction trust statute.⁴⁹ At issue in *In re Polidoro*⁵⁰ was whether the debtor, an officer, director, and shareholder of a contracting company, had debts under the New York statute which were nondischargeable in bankruptcy.⁵¹ The bankruptcy court determined that the debtor was personally liable under the New York construction trust statute as a result of mere knowledge of diversion of trust funds.⁵²

The court in *In re Polidoro* relied in part upon *Schwadron v. Freund*.⁵³ *Schwadron* involved a claim by purchasers of property in a development against officers, directors, and shareholders of the development company.⁵⁴ The purchasers alleged that the development company diverted funds paid by the purchasers and that the defendants were liable for their participation in the diversion.⁵⁵ Interpreting the New York construction trust statute,⁵⁶ the court stated that an individual who "actively" participated in the diversion, or had knowledge of the diversion, was liable under the statute.⁵⁷ The court determined as a matter of law that the president, who regularly signed corporate checks, who received wages of \$2,000 during the time plaintiffs made payments to the development company, and who did not deny having knowledge of the receipt and intended use of such funds, was personally liable.⁵⁸ The court denied summary judgment with respect to other defendants.⁵⁹ One defendant denied personally receiving or withdrawing funds from the development company, and evidence that he co-signed checks payable to contractors,

48. *Id.*

49. N.Y. LIEN LAW §§ 70-79a (McKinney 1966 & Supp. 1988).

50. 12 Bankr. 867 (Bankr. E.D.N.Y. 1981).

51. *Id.* at 868.

52. *Id.* at 870-71. For a more detailed discussion of this decision, see *infra* text accompanying notes 123-26.

53. 69 Misc. 2d 342, 329 N.Y.S.2d 945 (1972).

54. *Id.* at 343, 329 N.Y.S.2d 949.

55. *Id.*

56. Pursuant to the New York construction trust statute, a party damaged by a breach of trust may recover for "breach of trust or participation therein." N.Y. LIEN LAW § 77(3)(a)(i) (McKinney 1966 & Supp. 1988).

57. *Schwadron*, 69 Misc. 2d at 348, 329 N.Y.S.2d at 954.

58. *Id.* at 349, 329 N.Y.S.2d at 954.

59. *Id.*

materialmen, and suppliers was inconclusive of his liability.⁶⁰

The personal liability of husband and wife teams has been explored in decisions under the Wisconsin⁶¹ and Oklahoma⁶² construction trust statutes. *In re Thomas*⁶³ involved the nondischargeability of debts in bankruptcy under the Wisconsin statute⁶⁴ by a husband and wife engaged in the landscaping business.⁶⁵ Although the bankruptcy court and the district court found that the wife was not liable under the Wisconsin statute, the Court of Appeals for the Seventh Circuit disagreed. The Seventh Circuit held that when the wife deposited payments received from the plaintiffs and then disbursed the proceeds, she participated sufficiently in the diversion of trust funds to be liable under the statute.⁶⁶

The husband and wife debtors in the case of *In re Fisher*⁶⁷ were involved in the residential construction business in Oklahoma. The wife maintained the books and wrote out checks at the request and direction

60. *Id.*

61. The pertinent Wisconsin law states as follows:

Theft by Contractors. All monies, bonds or warrants paid or to become due to any prime contractor or subcontractor for public improvements are a trust fund only in the hands of the prime contractor or subcontractor and shall not be a trust fund in the hands of any other person. The use of the monies by the prime contractor or subcontractor for any purpose other than the payment of claims on such public improvement, before the claims have been satisfied, constitutes theft by the prime contractor or subcontractor and is punishable under § 943.20. This section shall not create a civil cause of action against any person other than the prime contractor or subcontractor to whom such monies are paid or become due. Until all claims are paid in full, have matured by notice and filing or have expired, such money, bonds and warrants shall not be subject to garnishment, execution, levy or attachment.

WIS. STAT. ANN. § 779.16 (West 1981).

62. The Oklahoma construction trust statute provides:

§ 152. Proceeds of building or remodeling contracts, mortgages or warranty deeds as trust funds for payment of lienable claims.

(1) The amount payable under any building or remodeling contract shall, upon receipt by any contractor or subcontractor, be held as trust funds for the payment of all lienable claims due and owing or to become due and owing by such contractors or subcontractors by reason of such building or remodeling contract.

§ 153. Payment of lienable claims.

(1) Such trust funds shall be applied to the payment of such valid lienable claims and no portion thereof shall be used for any other purpose until all lienable claims due and owing or to become due and owing shall have been paid.

(2) If the party receiving any money under Section 152 shall be a corporation, such corporation and its managing officers shall be liable for the proper application of such trust funds.

OKLA. STAT. ANN. tit. 42, §§ 152, 153 (West 1979 & Supp. 1988).

63. 729 F.2d 502 (7th Cir. 1984).

64. See *supra* note 61.

65. *In re Thomas*, 729 F.2d at 503.

66. *Id.* at 504 n.4.

67. 22 Bankr. 896 (Bankr. W.D. Okla. 1982).

of her husband; occasionally she would sign checks. Both the husband and wife signed the mortgage pertaining to the development of property by their company.⁶⁸ The court determined that the mortgage proceeds were trust funds, and that a diversion of trust funds had occurred under the Oklahoma statute.⁶⁹ Although the court found the husband liable for diversion of the trust funds, the wife was not liable because she was "an accommodation signatory to the mortgage" so that the mortgagee could protect itself from "possible spouse claims."⁷⁰

One may question the holding of *In re Fisher*. The wife maintained the company's books, and therefore would appear to have participated in the diversion of trust funds. The mortgagee may have requested the wife's signature to protect itself against spousal claims, however, that does not alter the fact that she played a substantial role in the business.⁷¹

In *Nuclear Corp. of America v. Hale*,⁷² a supplier of a steel fabrication company sued three individuals (Conley, Hale, and Ruby) who were shareholders, officers and directors of the steel fabrication company for diversion of trust funds under the Texas and Oklahoma construction trust statutes.⁷³ The supplier claimed that the steel fabrication company was paid funds on several projects but failed to pay the amounts due the supplier. Conley was the president and general manager, and was responsible for soliciting most of the company's business and preparing bids. He hired and fired employees, purchased routine supplies and equipment, consulted with Hale and Ruby on all major purchases of equipment, and signed jointly with Hale most of the company's checks. Hale was a director and secretary-treasurer; Ruby was a director and vice-president. Every month they received copies of bank deposits and financial reports. Hale took a more active part in the daily management of the company than Ruby. As the company became financially distressed, Conley resigned as general manager, and Hale took over the managerial responsibilities for the company. Hale and Conley also discussed which creditors would be paid out of the company's funds. One of the creditors paid was a company owned by Hale. Ruby's role in the company was passive and generally limited to that of a director. No evidence indicated that Ruby participated in any decision to favor certain creditors over others.⁷⁴

Since the supplier furnished materials for projects in both Texas and Oklahoma, the court analyzed the defendants' liability in accordance with the trust statutes of both states.⁷⁵ With respect to the Texas stat-

68. *Id.* at 897.

69. *Id.* at 898.

70. *Id.*

71. *In re Fisher* has not been cited by any other decision.

72. 355 F. Supp. 193 (N.D. Tex.), *aff'd*, 479 F.2d 1045 (5th Cir. 1973).

73. *Id.* at 195.

74. *Id.*

75. *Id.* at 197.

ute,⁷⁶ the court determined that personal liability depended upon whether the individuals "controlled" or "directed" any funds received by their company on the project.⁷⁷ The court held that Conley and Hale were liable because they had exercised control and direction over the trust funds on the Texas project.⁷⁸ Conversely, Ruby was not liable because there was no evidence that he exercised power over the disbursement of funds on the Texas project.⁷⁹

Under the Oklahoma statute,⁸⁰ the court found that Conley and Hale were personally liable as "managing officers"⁸¹ and again concluded that Ruby's passive role was insufficient to support a finding of personal liability.⁸² The court specifically held that Ruby's status as a stockholder, officer, and director was insufficient to show that he was a "managing officer."⁸³ Ruby's lack of participation in the day-to-day operations of the business, such as signing checks and consulting with employees on a regular basis, convinced the court that he was not liable under the Oklahoma statute.⁸⁴

In *Black v. O'Haver*,⁸⁵ an officer involved with the daily operation of a construction project was found personally liable under the Oklahoma construction trust statute.⁸⁶ The defendant O'Haver was an officer of a construction company which was building an apartment complex project funded by a mortgage company. When the project suffered financial difficulties, various subcontractors asserted lien claims.⁸⁷ The court master determined that an amount greater than the sum of the lien claims was applied by the construction company to purposes other than the lien claims.⁸⁸ O'Haver admitted that he bought materials, dealt with subcon-

76. The pertinent portion of the Texas statute in effect at the time of the court's decision was as follows:

All monies or funds paid to a . . . subcontractor . . . under a construction contract for the improvement of specific real property in this state, . . . are hereby declared to be Trust Funds for the benefit of the . . . materialmen who may . . . furnish . . . material for the construction . . . of any . . . building or improvement whatever upon such real property; provided, however, that monies paid to a . . . subcontractor . . . may be used to pay reasonable overhead of said . . . subcontractor, . . . directly related to such construction contract. The . . . subcontractor, . . . or any officer, director or agent thereof . . . having control or direction of same, is hereby made and constituted a Trustee of such funds . . . under his control or direction.

1967 Tex. Gen. Laws 770, *recodified as amended*, TEX. PROP. CODE ANN. §§ 162.001-.032 (Vernon 1984 & Supp. 1988).

77. *Nuclear Corp. of America*, 355 F. Supp. at 197.

78. *Id.*

79. *Id.*

80. *See supra* note 62.

81. *Nuclear Corp. of America*, 355 F. Supp. at 198.

82. *Id.*

83. *Id.*

84. *Id.*

85. 567 F.2d 361 (10th Cir. 1977).

86. *Id.* at 364.

87. *Id.*

88. *Id.* at 366.

tractors, wrote checks to subcontractors, signed payroll checks, and made bank loans for the project.⁸⁹ Distinguishing *Nuclear Corp. of America*, the Court of Appeals for the Tenth Circuit found that O'Haver was a "managing officer" under the Oklahoma statute and was therefore personally liable for the diversion of trust funds received from the mortgage company.⁹⁰ The court concluded that O'Haver was liable under the statute since he exercised his power to disburse corporate funds, took an active role in the construction company's daily affairs, and was in "complete active control" of the construction project.⁹¹

These Tenth Circuit decisions provide strong guidance for interpretation of the Maryland statute. In interpreting the Texas and Oklahoma statutes, the standard used for determining personal liability was whether the individuals "controlled" or "directed" the diversion of trust funds. The "controlled" or "directed" language in the Texas statute might be compared with the "retains or uses" language in the Maryland statute. Accordingly, *Nuclear Corp. of America* and *Black v. O'Haver* support an interpretation of the Maryland statute which finds that individuals who are not involved in the daily operation of a company, and who make no decisions concerning the disbursement of trust funds, are not personally liable. Further, these decisions support the proposition that under the Maryland construction trust statute one's position in a corporation alone will not be a sufficient basis for liability.

In summary, several observations can be made concerning the circumstances under which the Maryland courts may find personal liability. The broad statutory language and the decisions of other jurisdictions indicate that an officer, director, or employee who is actively involved with the day-to-day operations of a company is likely to be found personally liable. Conversely, those who have no active participation in the daily operation of the business, or the diversion of the trust funds, will probably not be personally liable. Despite the breadth of the statutory language, an individual's mere status as an officer, director, or employee does not appear to be sufficient to establish personal liability.

IV. FEDERAL BANKRUPTCY IMPLICATIONS OF THE MARYLAND CONSTRUCTION TRUST STATUTE.

A. *Provisions of the Federal Bankruptcy Code and the Construction Trust Statute*

Individuals held personally liable under the Maryland construction trust statute are likely to seek relief under the Federal Bankruptcy Code.⁹² One of the purposes of the Bankruptcy Code is to provide the

89. *Id.* at 367-68.

90. *Id.* at 368.

91. *Id.*

92. 11 U.S.C. §§ 101-1330 (1982 & Supp. IV 1986).

debtor a "fresh start" unhampered by preexisting debt.⁹³ This policy of the Bankruptcy Code is also implicitly set forth in sections 727, 1141, 1228 and 1328, which generally pertain to discharge of the debtor's antecedent debts.⁹⁴

The question arises as to whether the primary purpose of the Maryland statute — the imposition of personal liability upon the wrongful diverters of trust funds — may be circumvented by the diverters' seeking relief under the bankruptcy laws. In order to answer this question, a closer look at the Bankruptcy Code provisions relating to discharge of the debtor is necessary.

Despite the provision for a general discharge of debts provided by the Bankruptcy Code, not all debts are discharged in bankruptcy. The Bankruptcy Code provides that in certain situations, specific categories of debts are not discharged.⁹⁵ Of particular importance is section 523(a)(4), which provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

* * * *

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;⁹⁶

Although the Maryland construction trust statute does not enumerate criminal penalties for diversion of trust funds, the language of the statute appears to create a fiduciary relationship. Section 9-201(a) of the Real Property Code creates an express trust, and contractors or subcontractors receiving the trust funds hold such funds as a trustee.⁹⁷ Furthermore, personal liability under section 9-202 depends upon a finding of "intent to defraud."⁹⁸ Thus, it appears that the language of the Maryland construction trust statute creates a fiduciary obligation sufficient to except the debt of an individual based upon the statute from discharge under section 523(a)(4) of the Bankruptcy Code.

B. Judicial Construction of Similar Statutes in Other Jurisdictions

Considerable case law exists interpreting state statutes similar to the Maryland construction trust statute concerning the issue of dischargeability of debts under section 523(a)(4) of the Bankruptcy Code. The general rule is that if the state statute contains an express provision creating a trust, then an individual's debt resulting from diversion of the

93. See, e.g., *Brown v. Felsen*, 442 U.S. 127, 128 (1979); *Perez v. Campbell*, 402 U.S. 637, 648 (1971); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

94. 11 U.S.C. §§ 727, 1141, 1228, 1328 (1982 & Supp. IV 1986).

95. See *id.* § 523.

96. *Id.* § 523(a)(4).

97. MD. REAL PROP. CODE ANN. § 9-201(a) (1988).

98. *Id.* § 9-202.

trust funds is nondischargeable under section 523(a)(4).⁹⁹

*In re Thomas*¹⁰⁰ examined the nondischargeability of debts arising out of the Wisconsin construction trust statute pertaining to public improvements.¹⁰¹ As discussed above,¹⁰² the bankrupt debtors were a husband and wife engaged in the landscaping business. A general contractor who hired the debtors to perform landscaping work objected to the debtors' discharge under section 523(a)(4) and (6). The general contractor claimed that it paid the debtors substantial sums on a project, and that the debtors used the monies received for purposes other than paying suppliers and completing the contract work.¹⁰³ Both the bankruptcy court and the district court held that the husband, but not the wife, was acting in a fiduciary capacity with respect to the general contractor under the Wisconsin statute, and that some of the debt the husband owed to the general contractor was nondischargeable.¹⁰⁴

The general contractor appealed on the grounds that more of the debt was nondischargeable; the defendants did not cross-appeal.¹⁰⁵ Because the wife played a major role in the landscaping business, the Court of Appeals for the Seventh Circuit found that the general contractor had a right to proceed not only against the husband but also against the wife.¹⁰⁶ Accordingly, both the husband and wife were liable to the general contractor for nondischargeable debts under section 523(a)(4).¹⁰⁷

The effect of the Michigan construction trust statute¹⁰⁸ on the nondischargeability of debts under section 523(a)(4) was analyzed in *In re Johnson*.¹⁰⁹ The major supplier of materials for three of the debtor's projects filed a complaint to declare the debts nondischargeable under the predecessor to section 523(a)(4).¹¹⁰ The supplier contended that under the Michigan construction trust statute, the debtor was a "fiduciary" with respect to the payments received from the owners, and therefore, the debtor's failure to pay the supplier and the debtor's use of the money for personal and non-project related business expenses was a breach of the debtor's fiduciary duties, constituting a "defalcation" or

99. See, e.g., *In re Thomas*, 729 F.2d 502 (7th Cir. 1984); *In re Johnson*, 691 F.2d 249 (6th Cir. 1982); *Carey Lumber Co. v. Bell*, 615 F.2d 370 (5th Cir. 1980); *In re Weedman*, 65 Bankr. 288 (Bankr. W.D. Ky. 1986); *In re Polidoro*, 12 Bankr. 867 (Bankr. E.D.N.Y. 1981); *In re Kawczynski*, 442 F. Supp. 413 (W.D.N.Y. 1977).

100. 729 F.2d 502 (7th Cir. 1984).

101. See *supra* note 61.

102. See *supra* text accompanying notes 63-66.

103. *In re Thomas*, 729 F.2d at 503.

104. *Id.* at 504.

105. *Id.*

106. *Id.* at 504 n.4.

107. *Id.* at 507.

108. See *supra* note 43.

109. 691 F.2d 249 (6th Cir. 1982) (debtor was engaged in the business of constructing pole barns and other structures).

110. *Id.* at 250-51. The predecessor to section 523(a)(4) of title 11 of the United States Code was section 17(a)(4) of the Bankruptcy Act, which contained similar language.

"misappropriation."¹¹¹

The bankruptcy court held that the Michigan construction trust statute did not make the debtor a "fiduciary," noting that no facts indicated intentional or bad faith "defalcation" or "misappropriation."¹¹² The district court affirmed on the grounds that the supplier failed to prove that the debtor acted in bad faith or with intent to defraud.¹¹³ On appeal, the Court of Appeals for the Sixth Circuit addressed two issues: first, whether the debtor was a "fiduciary" under the Michigan construction trust statute, and second, whether specific intent or bad faith is necessary to constitute a "defalcation" or "misappropriation" under the predecessor to section 523(a)(4).¹¹⁴

The Sixth Circuit analyzed the provisions of the Michigan construction trust statute and held that the debtor was a fiduciary under the statute.¹¹⁵ The court determined that the term "fiduciary" applies only to express technical trusts, not to trusts which are imposed as a matter of equity,¹¹⁶ and that the trust relationship must exist prior to the act creating the debt and without reference to the debt.¹¹⁷ Examining the pertinent statutory language, the court held that the Michigan construction trust statute created an express trust arising prior to and separate from the act which created the debt and that intent or bad faith was not necessary to show a "defalcation."¹¹⁸

In *Carey Lumber Co. v. Bell*,¹¹⁹ the Court of Appeals for the Fifth Circuit interpreted the Oklahoma construction trust statute.¹²⁰ The court found that the filing of bankruptcy by the debtor, the managing officer of a residential construction company, did not discharge his debts to a supplier, because the Oklahoma statute created an express trust, and because the debtor was a "fiduciary" within the meaning of the predecessor to section 523(a)(4).¹²¹

Violations of the New York construction trust statute¹²² also result in nondischargeable debts. *In re Polidoro*¹²³ involved a debtor who was an officer, director, and shareholder of a contracting company which had purchased products from a supplier on open account for several projects. Although the debtor's company received full payment on the projects, the company did not pay the supplier. Instead, with the debtor's knowledge, it paid other obligations such as salaries, wages, general overhead

111. *Id.* at 251.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.* at 254.

116. *Id.* at 251.

117. *Id.* at 252.

118. *Id.* at 254, 257.

119. 615 F.2d 370 (5th Cir. 1980).

120. *See supra* note 62.

121. *Carey Lumber Co.*, 615 F.2d at 372-75.

122. N.Y. LIEN LAW §§ 70-79a (McKinney 1966 & Supp. 1988).

123. 12 Bankr. 867 (Bankr. E.D.N.Y. 1982).

expenses, and other debts.¹²⁴ The bankruptcy court held that the debtor's obligation to the supplier under the New York statute was non-dischargeable under section 523(a)(4).¹²⁵ In reaching its decision, the court found that since the New York statute created a trust relationship before the misapplication of funds, the debtor was a "fiduciary" under section 523(a)(4) and the debt was therefore nondischargeable.¹²⁶

In re Kawczynski,¹²⁷ also interpreting the New York construction trust statute,¹²⁸ involved an individual debtor engaged in the homebuilding business who failed to pay in full a subcontractor and supplier. The debtor had received payments from the owner and used some of the payments for purposes other than paying unpaid subcontractors and suppliers.¹²⁹ The unpaid subcontractor and supplier objected to the debtor's discharge under the predecessor to section 523(a)(4), but the bankruptcy court declared the debts dischargeable.¹³⁰ The district court reversed, holding that the New York statute created an express trust for the benefit of subcontractors and suppliers arising prior to any wrongdoing by the debtor. Therefore, the debtor was a "fiduciary" under the predecessor to section 523(a)(4).¹³¹ As a result, the debtor's obligations to the unpaid subcontractor and supplier were nondischargeable.¹³² The court also determined that the debtor's use of trust funds for legitimate business purposes, such as paying overhead expenses, nevertheless amounted to a diversion of trust funds and thus constituted a "defalcation" under the predecessor to section 523(a)(4).¹³³

Finally, *In re Weedman*¹³⁴ analyzed the Kentucky construction trust statute.¹³⁵ The debtor was a homebuilder who received full pay-

124. *Id.* at 868-69.

125. *Id.* at 871.

126. *Id.*

127. 442 F. Supp. 413 (W.D.N.Y. 1977).

128. N.Y. LIEN LAW §§ 70-79a (McKinney 1966 & Supp. 1988).

129. *In re Kawczynski*, 442 F. Supp. at 415.

130. *Id.*

131. *Id.* at 417.

132. *Id.* at 418.

133. *Id.* at 417-18.

134. 65 Bankr. 288 (Bankr. W.D. Ky. 1986).

135. The Kentucky construction trust statute provides:

- (1) Any contractor, architect or other person who builds, repairs or improves the property of another under such circumstances that a mechanic's or materialman's lien may be imposed on the property shall, from the proceeds of any payment received from the owner, pay in full all persons who have furnished material or performed labor on the property.
- (2) If any payment by the owner to the contractor, architect or other person is not sufficient to pay in full all bills for material and labor, then such claims shall be paid on a pro rata basis to the amount of payments received, unless otherwise agreed between the contractor, architect or other person and the holder of the claim for material or labor.
- (3) This section shall not apply where persons furnishing material or performing labor have waived in writing their right to file mechanics' or materialmen's liens.

ment from the owner for a project but failed to pay one of his suppliers. The supplier obtained a lien against the owner's residence, the owner obtained a judgment against the debtor, and the debtor filed bankruptcy.¹³⁶ The bankruptcy court held that the Kentucky construction trust statute created an express trust prior to, and independent of, any claim of misappropriation. Therefore, the debtor was a "fiduciary" under section 523(a)(4).¹³⁷ In addition, the failure to pay the supplier from the owner's payments to the debtor constituted a *prima facie* case of defalcation under section 523(a)(4).¹³⁸

As the decisions interpreting the construction trust statutes of Wisconsin, Michigan, Oklahoma, New York, and Kentucky indicate, the debtor becomes a "fiduciary" under section 523(a)(4) when the statute creates an express trust for the benefit of unpaid subcontractors. The Maryland construction trust statute also creates an express trust for the benefit of unpaid subcontractors.¹³⁹ Accordingly, it appears that an individual officer, director, or employee found personally liable under the Maryland construction trust statute will be subject to section 523(a)(4) of the Bankruptcy Code, and his debt will be nondischargeable in bankruptcy.

In contrast to the decisions of the courts previously mentioned, a number of courts have analyzed statutes with a purpose similar to Maryland's construction trust statute and have found debts resulting from these statutes not to be within section 523(a)(4). Those decisions, however, construed statutory language quite different from the Maryland statute.

The Court of Appeals for the Fifth Circuit has analyzed not only the Oklahoma statute,¹⁴⁰ but has also interpreted the Louisiana, Georgia, and Texas construction trust statutes.¹⁴¹ *In re Angelle*¹⁴² discussed the effect of a Louisiana criminal statute¹⁴³ which imposed penalties upon a contractor or subcontractor who failed to pay claims for material and

KY. REV. STAT. ANN. § 376.070 (Baldwin 1981).

136. *In re Weedman*, 65 Bankr. at 290.

137. *Id.* at 290-91.

138. *Id.* at 291.

139. MD. REAL PROP. CODE ANN. § 9-201(a) (1988).

140. *See Carey Lumber Co. v. Bell*, 615 F.2d 370 (5th Cir. 1980).

141. *See In re Boyle*, 819 F.2d 583 (5th Cir. 1987); *In re Cross*, 666 F.2d 873 (5th Cir. 1982); *In re Angelle*, 610 F.2d 1335 (5th Cir. 1980).

142. 610 F.2d 1335 (5th Cir. 1980).

143. Louisiana law at the time of the court's decision provided as follows:

Any person, contractor or subcontractor or agent of a contractor or subcontractor who has applied any money received on account of any contract including contracts and mortgages for interim financing, for the construction, erection, or repair of any building, structure, or other improvement to any other purpose than the settlement of claims for material and labor due or to become due for said construction or under the contract shall, in case of default on the contract, or default in payment of claims for material or labor, be fined not less than one hundred dollars nor more than five hundred dollars and imprisoned for not less than thirty days nor more

labor out of monies received from a project. In determining whether the individual debtor, a homebuilder, was a "fiduciary" under the predecessor to section 523(a)(4) as a result of the Louisiana statute, the Fifth Circuit held that because no trust arose under the Louisiana statute prior to misappropriation, a debtor who violates the Louisiana statute is not a "fiduciary."¹⁴⁴ Therefore, any debt resulting from the Louisiana statute is dischargeable in bankruptcy. Analyzing a similar Georgia statute¹⁴⁵ in *In re Cross*,¹⁴⁶ the Fifth Circuit held that a debtor did not attain "fiduciary" status through a criminal provision which prohibited the misapplication with intent to defraud of money advanced for real property improvements.¹⁴⁷ Neither the Louisiana statute nor the Georgia statute, however, contained a provision creating an express trust.¹⁴⁸ Accordingly, these statutes may be distinguished from the Maryland construction trust statute.

In *In re Boyle*,¹⁴⁹ the Fifth Circuit held that under the Texas construction trust statute,¹⁵⁰ the diverter's debts would be nondischargeable

than six months, and in default of fine, imprisoned for not less than thirty days nor more than six months additional.

1960 La. Acts 554, § 1, *codified as amended*, LA. REV. STAT. ANN. § 14:202 (1986).

144. *In re Angelle*, 610 F.2d at 1336, 1340.

145. Georgia Law provides as follows:

(a) Any architect, landscape architect, engineer, contractor, subcontractor, or other person who with intent to defraud shall use the proceeds of any payment made to him on account of improving certain real property for any other purpose than to pay for labor or service performed on or materials furnished by his order for this specific improvement while any amount for which he may be or become liable for such labor, services, or materials remains unpaid commits a felony and, upon conviction thereof, shall be punished by imprisonment for not less than one year nor more than five years or upon the recommendation of the jury or in the discretion of the trial judge, punished for a misdemeanor, provided that, in addition to the above sanctions, where a corporation's agent acts within the scope of his office or employment and on behalf of the corporation and with intent to defraud uses such proceeds for purposes other than for property improvements or where a corporation's board of directors or managerial official, the latter acting within the scope of his employment and on behalf of the corporation recklessly tolerates or, with intent to defraud, authorizes, requests, or commands the use of such proceeds for purposes other than for property improvements, the corporation commits a felony and, upon conviction thereof, shall be punished by a fine of not less than \$1,000.00 nor more than \$5,000.00.

(b) A failure to pay for material or labor furnished for such property improvements shall be prima-facie evidence of intent to defraud.

1941 Ga. Laws 480, § 1, *recodified as amended*, GA. CODE ANN. § 16-8-15 (1984).

146. 666 F.2d 873 (5th Cir. 1982).

147. *Id.* at 881 n.13.

148. *Id.*; see also *supra* notes 143, 145.

149. 819 F.2d 583 (5th Cir. 1987).

150. The relevant statutory provisions which the court analyzed were as follows:
Section 162.001

(a) Construction payments are trust funds under this chapter if the payments are made to a contractor or subcontractor or to an officer, director,

pursuant to section 523(a)(4) only if intent to defraud was shown.¹⁵¹ The facts of *In re Boyle*, however, would probably lead to a different result under the Maryland statute. The plaintiff in that decision proved diversion of trust funds, but not wrongful intent.¹⁵² Conversely, under section 9-203 of the Maryland construction trust statute, proof of diversion is *prima facie* evidence of intent to defraud.¹⁵³ Therefore, because the Texas statute had no provision similar to section 9-203, the holding in *In re Boyle* cannot be relied upon when interpreting the Maryland statute.

The Eighth and Ninth Circuits, interpreting criminal statutes similar to the Louisiana and Georgia statutes analyzed by the Fifth Circuit, found that the statutes created no express trust. Therefore, debts of a

or agent of a contractor or subcontractor, under a construction contract for the improvement of specific real property in this state.

(b) Loan receipts are trust funds under this chapter if the funds are borrowed by a contractor, subcontractor, or owner or by an officer, director, or agent of a contractor, subcontractor, or owner 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.

Section 162.002

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.

Section 162.003

An artist, 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.

Section 162.004

(b) The Texas Trust Act . . . does not apply to any trust created under this chapter

Section 162.031

(a) Except as provided by Subsection (b), a trustee who, with intent to defraud, directly or indirectly retains, uses, disburses, or otherwise diverts trust funds without first fully paying all obligations incurred by the trustee to the beneficiaries of the trust funds has misapplied the trust funds.

(b) A trustee may use trust funds to pay the trustee's reasonable overhead expenses that are directly related to the construction or repair of the improvement.

Section 162.032

(a) A trustee who misapplies trust funds amounting to less than \$250 commits an offense punishable by confinement in jail for not more than two years and by a fine of not more than \$500 or by the confinement without the fine.

(b) A trustee who misapplies trust funds amounting to \$250 or more commits an offense punishable by imprisonment in the Texas Department of Corrections for not more than 10 years.

Id. at 585-86 (quoting from TEX. PROP. CODE ANN. §§ 162.001-.032 (Vernon 1984)).

151. *Id.* at 592.

152. *Id.*

153. MD. REAL PROP. CODE ANN. § 9-203 (1988).

contractor who misappropriated trust funds were dischargeable in bankruptcy.¹⁵⁴

V. CONCLUSION

The Maryland construction trust statute complements and reinforces the rights and responsibilities of contractors and subcontractors in the construction industry. Under the statute, officers, directors, and employees of contractors and subcontractors are exposed to personal liability. Monies received by a contractor or subcontractor on a construction project are deemed to be held in trust for the payment of sums due to lower-tiered subcontractors. Any officer, director, or employee of a contractor or subcontractor who, with intent to defraud, retains or uses the monies held in trust for any purpose other than to pay lower-tiered subcontractors is personally liable to any person damaged by such an action. Mere use of the trust funds for any purpose other than the payment of subcontractors on the project constitutes *prima facie* evidence of intent to defraud. Personal liability for diversion of trust funds probably extends only to officers, directors, or employees actively involved with the daily operations of a company. Accordingly, an individual's mere status as an officer, director, or employee is not likely to result in personal liability.

Once an individual has been found liable under the statute, it appears that the individual will not be able to evade responsibility for the debt by filing bankruptcy. Section 523(a)(4) of the Bankruptcy Code excepts from the general discharge in bankruptcy debts for fraud or defalcation while acting in a fiduciary capacity. Since the Maryland statute creates an express trust, an individual found liable is likely to be considered a "fiduciary" within the meaning of section 523(a)(4). As a result, the debt of an individual arising out of the Maryland statute is probably nondischargeable in bankruptcy.

154. See *In re Pedrazzini*, 644 F.2d 756, 759 (9th Cir. 1981) (interpreting CAL. PENAL CODE § 484(b) (1988)); *In re Dloogoff*, 600 F.2d 166, 169-70 (8th Cir. 1979) (interpreting NEB. REV. STAT. § 52-123 (1984)).