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Reducing Risk of Theft by Contractor: Five Things to Consider

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A claim for theft by contractor is a powerful weapon in construction litigation.

Under Wis. Stat. section 779.02(5), all funds paid by an owner to a prime contractor or subcontractor for improvements to real property are held in trust for the payment of labor, services, materials, plans, and specifications used to improve the property. Except in the case of a legitimate dispute, the misuse of those funds by a contractor or subcontractor may constitute theft by contractor.

A violation of section 779.02(5) is "punishable under s. 943.20," Wisconsin's criminal theft statute. The civil remedy for statutory theft is found in Wis. Stat. section 895.446, which allows recovery of treble damages, costs, and reasonable attorney fees, including costs of investigation and litigation. Personal liability lies against any officers, directors, members, partners, or agents responsible for misappropriating funds even if those individuals act through or on behalf of a corporation or LLC.

Given the potentially significant recoveries and personal liability, theft by contractor claims are frequently pled in construction disputes as a source of litigation leverage beyond ordinary breach-of-contract remedies.

Because theft by contractor claims expose parties to significant financial and litigation risk, construction attorneys should carefully consider when such claims may arise and what steps can be taken to either support or defend against them.

Draft Construction Contracts Carefully

The starting point is the construction contract. Clear contract terms can help define when payment obligations arise and when funds may legitimately be withheld.

Common provisions that may affect theft by contractor exposure include:

- retention provisions allowing for holdback of funds due to contractors provided certain conditions are met;
- payment clauses requiring work to be properly completed and approved by the architect, engineer, or owner's representative as a condition of payment;
- contractual mechanisms for determining and liquidating back-charges; and
- procedures for resolving disputes regarding the value or quality of work.

Carefully drafted payment provisions can help frame whether a dispute over payment is legitimate — or whether withheld funds may instead be viewed as misuse of trust funds.

Pay What Is Actually Due — and Only Withhold What Is Truly Disputed

Wisconsin law recognizes that contractors may withhold funds that are legitimately disputed. However, the statute strictly limits the scope of permissible withholding.

Only the amount of funds "which are the subject of a bona fide dispute and then only to the extent of the amount actually in dispute" may be withheld.[1]

Outside a legitimate dispute, however, the statutory trust obligation is strict. The Wisconsin Supreme Court has emphasized that funds paid to a contractor for improvements are not owned by the contractor, but are held in trust until subcontractors and suppliers are paid.[2]

Track Project Funds with Clear Accounting Practices

Because owner payments or higher-tier contractor payments are treated as trust funds, contractors should maintain accounting practices that clearly demonstrate how project funds were handled.

Helpful practices may include:

- maintaining separate accounting for each project;
- segregating funds when possible;
- creating separate accounts for disputed funds; and
- maintaining detailed records of payments to subcontractors and suppliers.

These practices can become critical evidence if a dispute arises.

In *Century Fence Co. v. American Sewer Services, Inc.*, the Wisconsin Court of Appeals held that a prime contractor violated the theft by contractor statute after depositing project funds into its general account and using those funds to pay business expenses rather than paying the subcontractor that performed the work.[3]

The Wisconsin Supreme Court has likewise held that trust funds cannot be used for the "ordinary and normal expenses of the business" until subcontractor claims are paid.[4] In *Burmeister*, the court found it immaterial that the defendant gained no personal benefit from the use of the money.

Do Not Assume Theft by Contractor Requires a Conscious Intent to 'Steal'

Many contractors assume that theft by contractor liability requires proof that the contractor intended to steal funds. In practice, the required intent can often be inferred from the circumstances.

The Wisconsin Supreme Court clarified the governing framework in *Tri-Tech Corp. of America v. Americomp Services, Inc.*,[5] holding that a civil theft by contractor claim requires proof of both:

- a violation of the trust-fund provisions of Wis. Stat. section 779.02(5), and
- the criminal intent required by Wis. Stat. section 943.20. Refusal to turn over trust funds upon demand by a beneficiary is prima facieevidence of criminal intent per Wis. Stat. section 943.20(1)(b).

Courts have also emphasized that contractors cannot prioritize their own profits ahead of other project obligations. In *State v. Keyes*,[6] the court explained that the statute prohibits contractors from paying themselves profits from project funds before other subcontractors have been paid for labor and materials.

Protect Yourself by Segregating Disputed Funds

One practical way to reduce potential exposure is to segregate disputed funds rather than use them for other purposes.

Establishing a separate account for funds that are genuinely disputed can help demonstrate that the contractor did not convert those funds for other uses. While this approach will not protect against a claim alleging an unreasonable refusal to pay amounts clearly owed, it may help support the argument that the funds were never misused.

Courts have emphasized that theft by contractor occurs when trust funds are misappropriated, not when litigation later resolves the payment dispute.[7]

A Final Note on Treble Damages and Attorney Fees

One of the most significant aspects of theft by contractor claims is the potential recovery of treble damages and attorney fees under Wis. Stat. section 895.446.

Those enhanced remedies are not automatic. Courts retain discretion in determining whether to award exemplary damages or full litigation costs depending on the circumstances of the case. For example, in *Thunderbird Eng'g, Inc. v. American Design, Inc.*, [8] the court found the subcontractor, although unpaid, was not entitled to damages because the failure to pay was due to the subcontractor's allegedly deficient and incomplete work.

While it is possible to avoid theft by contractor liability when payments are withheld, the prudent course is to avoid such claims in the first place by clearly and comprehensively addressing in the contract the conditions under which payment will be due. If that is not possible, trust funds should be held in a separate interest-bearing account.

Endnotes

[1] *Loehrke v. Wanta Builders, Inc.*, 151 Wis. 2d 695, 702–04, 445 N.W.2d 717 (Ct. App. 1989).
[2] *State v. Blaisdell*, 85 Wis. 2d 172, 179–80, 270 N.W.2d 69 (1978).
[3] *Century Fence Co. v. American Sewer Services, Inc.*, 2021 WI App 75, ¶¶ 14–16, 399 Wis. 2d 742, 967 N.W.2d 32.
[4] *Burmeister Woodwork Co. v. Friedel*, 65 Wis. 2d 293, 300, 222 N.W.2d 647 (1974).
[5] *Tri-Tech Corp. of America v. Americomp Services, Inc.*, 2002 WI 88, ¶¶ 24–30, 254 Wis. 2d 418, 646 N.W.2d 822.
[6] *State v. Keyes*, 2007 WI App 163, ¶¶ 14-16, 304 Wis. 2d 372, 736 N.W.2d 904.
[7] *KBS Constr., Inc. v. McCullough Plumbing, Inc.*, 2010 WI App 19, ¶ 23, 323 Wis. 2d 276, 779 N.W.2d 723.
[8] *Thunderbird Eng'g, Inc. v. American Design, Inc.*, No. 2021AP1985, unpublished slip op., ¶ 50 (Wis. Ct. App. July 7, 2023).

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