

STATE OF WISCONSIN  
SUPREME COURT

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APPEAL NO: 2008AP1867

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KBS CONSTRUCTION, INC.

Plaintiff-Appellant-Cross-Respondent,

v.

McCULLOUGH PLUMBING, INC.  
n/k/a PIRATE PLUMBING, INC.

Defendant-Respondent-Cross-Appellant-Petitioner.

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***AMICUS CURIAE BRIEF OF AMERICAN SUBCONTRACTORS  
ASSOCIATION, INC.***

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Appeal from the December 23, 2009 Decision of the Wisconsin  
Court of Appeals, District IV in an Appeal of the Decision  
of the Circuit Court of Dane County  
Honorable Richard G. Niess, Presiding  
Circuit Court Case No. 2005CV2590

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## INTEREST OF AMICUS CURIAE

The American Subcontractors Association (“ASA”) is a non-profit, national, membership trade association of 5,500 subcontractors, specialty trade contractors and suppliers in the construction industry. As a national organization dedicated to the equitable treatment of construction subcontractors, ASA has acted on behalf of all subcontractors by promoting legislative action and by intervening in significant litigation affecting the industry at large.

ASA believes the Circuit Court for Dane County (the “circuit court”) erred when it determined McCullough Plumbing, Inc., n/k/a Pirate Plumbing, Inc. (“McCullough”) did not suffer any damage or loss “by reason of” KBS Construction, Inc.’s (“KBS”) deliberate failure to follow the requirements of Wis. Stat. § 779.02(5) to hold funds in trust for purposes of payment of its subcontractors.

The decision below raises significant legal issues affecting subcontractors throughout Wisconsin in their day to day business operations. Construction is a large and strong industry in Wisconsin. ASA’s membership has an interest in this case because it involves Wis. Stat. § 779.02(5), Wisconsin’s Construction Trust Fund Statute (the “trust fund statute”), a statute whose purpose is to protect subcontractors by securing payments to subcontractors and workers. *State v. Keyes*, 2008 WI 54, ¶ 29, 309 Wis. 2d 516, 750 N.W.2d 30.

## SUMMARY OF THE ARGUMENT

The decision below warrants review because it meets the pertinent criteria of Wis. Stat. § 809.62(1r)(b), (c), and (d). This Court's review will develop and clarify this State's approach to its trust fund statute, Wis. Stat. § 779.02(5), and will have a wide reaching affect on the construction industry, which comprises a significant portion of this State's economy. There are many subcontractors working in Wisconsin, relying on the trust fund statute to safeguard them against misappropriation of funds, rightfully belonging to them, by prime contractors.

This Court needs to clarify two very important issues that will have a wide reaching affect on subcontractors. First, this Court needs to clarify the language of § 779.02(5) as it applies to the use of trust fund monies when there is a pending disputed claim.

The plain language of the statute clearly requires a prime contractor to hold in trust monies paid to it for the benefit of its subcontractors. Having a "bona fide dispute" under § 779.02(5) does not relieve the prime contractor of its fiduciary duty to hold the monies in trust under the statute. Rather, having a "bona fide dispute" is a defense to breach of a prime contractor's fiduciary duty under the statute, meaning a prime contractor does not breach its fiduciary duty to its subcontractor by refusing to pay out when there is a bona fide

dispute. *Loehrke v. Wanta Builders, Inc.*, 151 Wis. 2d 695, 704, 445 N.W.2d 717, 721 (Ct. App. 1989). To interpret § 779.02(5) as excusing prime contractors from holding monies in trust while a dispute is pending violates the purpose of the trust fund statute, which is to protect subcontractors and ensure they get paid.

Second, this Court needs to address the fact the circuit court and the court of appeals incorrectly imposed an additional element on McCullough to prove its theft by contractor claim, in conflict with controlling Wisconsin Supreme Court precedent. This Court has clearly stated the four essential elements necessary to state a claim under § 779.02(5). *Paulsen Lumber, Inc. v. Anderson*, 91 Wis. 2d 692, 695, 283 N.W.2d 580, 581-82 (1979). None of these elements include the additional causation requirement articulated by the court of appeals.

Wis. Stat. § 895.446, previously numbered Wis. Stat. § 895.80, was created in 1995. Mark R. Hinkston, *Wisconsin's Construction Trust Fund Statute: Protecting Against Theft By Contractor*, Wis. Law., May 2005, at 19. Section § 895.446 provides broader remedies, such as the possibility of treble damages, to those injured by theft. *Id.* However, a civil cause of action for theft by contractor clearly existed prior to the promulgation of § 895.446, as can be seen in *Paulsen Lumber*, 91 Wis. 2d at 695, 283 N.W.2d at 581-82. Had the Legislature intended to add an additional element to prove a theft by

contractor claim, it would have amended § 779.02(5) to add the additional element.

Both the circuit court and the court of appeals assumed “for the sake of argument” that KBS intentionally violated § 779.02(5). Thus, under *Paulsen Lumber*, both courts acknowledged McCullough successfully proved its “cause” of action. However, even assuming KBS’ intentional violation of § 779.02(5) by failing to maintain funds in trust to pay McCullough, the court of appeals affirmed the circuit court’s finding that this failure did not cause McCullough’s damages, even though McCullough was not and still has not been paid for the entirety of the work it completed for KBS. The circuit court incorrectly added an additional element of proof to McCullough’s theft by contractor claim, and the court of appeals erroneously upheld it.

The court of appeals’ decision creates the very problem the trust fund statute seeks to avoid. This Court has made clear on numerous occasions that the purpose of the trust fund statute is to assist subcontractors in getting paid. *Kraemer Bros. v. Pulaski State Bank*, 138 Wis. 2d 395, 402-03, 406 N.W.2d 379, 383 (1987); *see also State v. Keyes*, 2008 WI 54, ¶ 29. It is a safeguard for subcontractors.

The court of appeals acknowledged that under § 779.02(5) a theft occurs at the time the funds are misappropriated; however, rejected the fact that the theft caused the injury. Wis. Stat. § 779.02(5)

makes “theft by contractors” a theft under the criminal statute, Wis. Stat. § 943.20, the same as if someone stole a car. No one would deny the theft of the car caused the car owner’s injury (his injury being he no longer has his property). The circuit court and the court of appeal’s decision create an additional element of proof, nearly impossible to meet, eviscerating the very protections the trust fund statute intended to provide for subcontractors. This presents a novel question that will have great impact statewide on the subcontractors working in Wisconsin. Further, the court of appeals’ decision flies in the face of nearly 100 years of Wisconsin law protecting subcontractors. For these reasons, more fully set forth below, review should be granted.

### **ARGUMENT**

I. THE COURT OF APPEALS’ DECISION EVISCERATES THE TRUST FUND STATUTE THAT HAS BEEN PROTECTING SUBCONTRACTORS FOR NEARLY 100 YEARS.

A. The Policy Behind the Trust Fund Statute is to Ensure Subcontractors Get Paid.

When Wisconsin first enacted its construction lien statutes in 1849, the statutes contained no restrictions on a contractor’s project funds expenditure. Hinkston, at 18. However, it was generally accepted that a contractor had a duty to use project funds to pay its subcontractors and suppliers. *Id.*; see also *Pauly v. Keebler*, 175 Wis.

428, 185 N.W. 554, 557 (Wis. 1921) (“Statutes for the creation and enforcement of mechanics’ liens are upheld because they give a security to those whose labor and material have gone into the structure. They rest on claims of natural justice, and in part on the maxim that the laborer is worthy of his hire.”). Even though it was generally accepted in the construction industry that a contractor had a duty to use project funds to pay its subcontractors, some contractors chose to ignore this duty and squander the money. Hinkston, at 18. At this point in history under the language of the statute, the contractor incurred no criminal liability for his actions. *Id.*

Thus, in 1913, the Wisconsin Legislature enacted the trust fund statute to stem the injustice that occurred when a subcontractor went unpaid. *Id.* The Legislature codified the prime contractor’s moral obligation to pay its subcontractor, imposing penalties when funds due a subcontractor were misappropriated. *Id.*

What was created was Wis. Stat. § 779.02(5). It provides, in pertinent part:

“[A]ll moneys paid to any prime contractor or subcontractor by any owner for improvements, constitute a trust fund only in the hands of the prime contractor or subcontractor to the amount of all claims due or to become due or owing from the prime contractor or subcontractor for labor, services, materials, plans, and specifications used for the improvements, until all the claims have been paid, and shall not be a trust fund in the hands of any other person. The use of any such moneys by any prime contractor or subcontractor for any other purpose until all claims, except those which are the subject of a bona fide dispute and then only to the extent of the amount actually in dispute, have been paid in full or proportionally in cases of a deficiency, is theft by the prime contractor or subcontractor of moneys so misappropriated and is punishable under s. 943.20.

Wisconsin courts have clearly stated on numerous occasions that the purpose of the trust fund statute is to create a trust to insure payments made to prime contractors are used to pay subcontractors and workers. *Keyes*, 2008 WI 54, ¶ 29; *Kraemer Bros. v. Pulaski State Bank*, 138 Wis. 2d 395, 402-03, 406 N.W.2d 379, 383 (1987) (“The policy behind the statute is to assist subcontractors in getting paid.”); *Capital City Sheet Metal, Inc. v. Voytovich*, 217 Wis. 2d 683, 689, 578 N.W.2d 643, 646 (Ct. App. 1998) (internal citations omitted) (“The statutory language is plain and unambiguous. It imposes a trust on funds the contractor receives from the owner, requiring that those funds be used only for payments ‘for labor and materials used’ in performing the contract. Using the funds for some other purpose—whether personal or corporate—violates the statute, and the officers of the corporation may be held personally liable to the subcontractors and suppliers. The statute’s purpose is simply stated: ‘[It imposes a trust upon funds] received by the contractor for a particular purpose, the construction of improvements upon property. The statute imposes the trust to insure that one who receives money for this purpose uses it to that end.’”).

The payments made to a prime contractor “*are not actually owned by the prime contractor*”; rather, the funds received by the prime contractor are for a particular purpose, namely the construction

of improvements upon property. *Keyes*, 2008 WI 54, ¶ 29 (emphasis added); *see also State v. Sobkowiak*, 173 Wis. 2d 327, 334, 496 N.W.2d 620, 623 (Ct. App. 1992) (“The prime contractor does not actually own the funds. His only interest is that of a trustee.”)

When prime contractors use the monies paid to them for “any other purpose” than paying its subcontractor, § 779.02(5) makes this misappropriation a theft under Wis. Stat. § 943.20. Section § 779.02(5) contemplates that disputes will arise between prime contractors and subcontractors, but requires the prime contractor to hold in trust the amount of the funds in dispute. This ensures orderly distribution of funds when there is a dispute, namely, it requires the prime contractor to hold in trust the amount in dispute so if it is determined the prime contractor owes the subcontractor the disputed funds, the funds are available to pay the subcontractor. The trust fund statute is not intended to allow a prime contractor to spend funds in dispute, thus forcing a subcontractor to scramble for payment once it is determined the prime contractor owes the subcontractor the disputed funds.

The “bona fide dispute” language in the trust fund statute provides a defense against a claim by a subcontractor for a prime contractor’s breach of fiduciary duty when it refuses to pay out funds subject to a bona fide dispute. As the court of appeals stated in

*Loehrke*, “refusal with good cause to pay a disputed amount on contract cannot and should not be a tort. If the prime contractor has good cause to refuse to pay, it has not violated its fiduciary duty, no tort results and punitive damages are unavailable.” 151 Wis. 2d at 704, 445 N.W.2d at 721. But a bona fide dispute does not excuse a prime contractor from holding the funds in trust, only from paying them out until the dispute is resolved.

B. The Circuit Court and Court of Appeals Created an Additional Element of Proof for a Theft By Contractor Claim that is Nearly Impossible to Meet.

Wisconsin has allowed civil claims for theft by contractor well before the promulgation of Wis. Stat. § 895.446. *See Paulsen Lumber*, 91 Wis. 2d at 695, 283 N.W.2d at 581-82. The four elements necessary to state a claim under § 779.02(5) are: (1) the owner purchased labor or materials; (2) the labor or materials were provided; (3) the defendant was paid for the labor or materials by the owner or mortgagee; and (4) the defendant used the trust fund money for a purpose other than to pay for the labor or materials provided. *Id.* The *Paulsen* court further stated the plaintiff has the burden of proof “on each of these elements.” *Id.* at 696, 283 N.W.2d at 582. This Court has made clear these four elements, and only these four elements, are the elements a plaintiff must prove to establish a civil theft by contractor claim.

The court of appeals incorrectly cites *Tri-Tech Corp. of America v. Americomp Services, Inc.*, 2002 WI 88, 254 Wis. 2d 418, 646 N.W.2d 822, for the proposition that in a civil action for theft by contractor, the victim must prove the elements of both civil theft by contractor under § 779.02(5) and criminal theft under § 943.20. *KBS Construction, Inc. v. McCullough Plumbing, Inc.*, 2009 WL 4931573, ¶ 18. This is a misstatement of law.

Not only is it contrary to this Court's decision in *Paulsen Lumber*, it is contrary to this Court's decision in *Americomp Services*, where this Court stated that to obtain treble damages for theft by contractor under § 779.02(5), the elements of **both** the civil and the criminal statutes must be proven, by the civil preponderance burden of proof. *Americomp Services*, 2002 WI 88, ¶ 24. *Americomp Services* was addressing the issue of treble damages; it did not add any additional element of proof for a civil theft by contractor claim.

Further the elements for proving a criminal cause of action are the defendant: (1) acted as a prime contractor; (2) received money from an owner or mortgagee for an improvement; (3) intentionally used the money for purposes other than paying bona fide claims for labor or materials before paying those claims; (4) had no authority or consent to so use the funds; (5) knew the use was without consent and contrary to the defendant's authority; and (6) used the money with the intent to

convert it to the defendant's own use or the use of another. *Id.* ¶ 26. There is no additional element of proof, as suggested by the court of appeals, in either a criminal or civil cause of action for theft by contractor.

The court of appeals upheld not only a clearly erroneous finding of fact, but a dangerous one. Not only did the court of appeals add an additional element of proof to a civil theft by contractor cause of action unsupported by Wisconsin law, the additional element is nearly impossible to prove. By rejecting the finding that McCullough sustained a loss caused by *KBS* stealing its money, it created a legal standard in which it is nearly impossible for a subcontractor to prove causation of its damages. If the theft did not cause the subcontractor's damage, what did? For civil causes of action, Wisconsin utilizes a "substantial factor" test to determine causation. *Fischer v. Ganju*, 168 Wis. 2d 834, 857, 485 N.W.2d 10, 19 (1992). Substantial factor "denotes that the defendant's conduct has such an effect in producing the harm as to lead the trier of fact, as a reasonable person, to regard it as a cause, using that word in the popular sense." *Id.* Merriam-Webster's dictionary defines "cause" as "something that brings about an effect or a result." See <http://www.merriam-webster.com/dictionary/cause>.

McCullough was not paid and still has not been paid for the work it performed on behalf of KBS because KBS did not hold in trust the funds to cover the amount of its dispute with McCullough. Had KBS retained the funds in trust, as was its duty under the statute, there would be money to pay McCullough. It is clear that KBS' failure to retain the funds in trust was a substantial factor as to why McCullough was not paid.

The circuit court and court of appeals erroneously looked at the findings of fact regarding *why* KBS failed to pay funds to McCullough during the dispute. This is irrelevant. The only findings of fact the circuit court should have considered was the fact KBS failed to maintain a trust as was its duty under the statute, and the fact McCullough has not been paid for the work it performed. KBS argued it had other money to cover the judgment. Even if this were true, this too is irrelevant. The availability of other funds to later pay a subcontractor does not negate a prime contractor's duty to maintain a trust. *See Weather-Tite v. Lepper*, 25 Wis.2d 70, 74, 130 N.W.2d 198, 200 (1964).

It was clearly erroneous for the circuit court to consider this evidence to show McCullough was not damaged by KBS' conversion. Thus, it is imperative the Court review this case. Not only does the court of appeals' decision fly in the face of nearly 100 years of

Wisconsin law protecting subcontractors, it presents a novel question of law. Through upholding the circuit court's finding of fact, the court of appeals created a nearly impossible legal standard of causation, one at odds with the unambiguous language and intent of the theft by contractor statute, and one that makes it nearly impossible for a subcontractor to prove the theft of its money caused its damages. The evisceration of the protections the Legislative put into place so long ago to protect subcontractors will have a devastating effect on the subcontractors working in Wisconsin, and on Wisconsin's construction industry as a whole.

### **CONCLUSION**

ASA respectfully requests the Court grant McCullough's Petition for Review.

Dated: February 2, 2010.

Respectfully submitted,

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## **CERTIFICATION**

I certify that this brief conforms to the rules contained in § 809.19(8)(b) and (c) for a brief and appendix produced using the following font:

Proportional serif font; Min. printing resolution of 200 dots per inch, 13 point body text, 11 point for quotes and footnotes, maximum of 60 characters per full line of body text.

The length of this brief is 2,999 words.

Dated: February 2, 2010.

COOK & FRANKE S.C.

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**CERTIFICATE OF COMPLIANCE WITH RULE 809.19(12)**

I hereby certify that:

I have submitted an electronic copy of this brief, excluding the appendix, if any, which complies with the requirements of s. 809.19(12). I further certify that:

This electronic brief is identical in content and format to the printed form of the brief filed as of this date.

A copy of this certificate has been served with the paper copies of this brief filed with the court and served on all opposing parties.

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