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**THE TROUBLE WITH TRUSTS: A SURVEY OF CASE LAW  
INVOLVING CONSENSUAL TRUSTS AND CONTRACT  
SURETIES**

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## I. INTRODUCTION

Contract sureties are like all creditors who work that dark side of the moon known by the euphemism of “special assets” and its many variants: sureties spend much of their time protecting their collateral and its priorities from the claims of competing creditors. And when a surety decides to provide financial assistance to a troubled principal, an early determination must be made about how best to protect the funds that assure the orderly prosecution of the bonded work. These funds most often consist, in the financial assistance context, of proceeds from bonded contracts together with loan proceeds advanced by the surety to supplement the principal’s capital needs.

This article will examine one form of account relationship frequently used by contract sureties to protect loan proceeds and bonded revenues - the trust account. Other forms of bank accounts used by sureties to the same purpose - joint control<sup>1</sup> and cash collateral<sup>2</sup> accounts - are discussed elsewhere. Further, this article will not discuss statutorily imposed trusts on contract revenues, which are also well documented in other sources.<sup>3</sup>

Consensual trusts used by sureties typically take one of two forms. First, many indemnity agreements used by sureties impose a trust on bonded contract revenues for the benefit of those to whom the surety is or may become liable under its bonds.<sup>4</sup> Second, when providing financial assistance a surety and its principal will often enter into a separate trust agreement which amplifies the trust language of the indemnity agreement. This separate trust agreement will provide for the establishment of a trust account in a financial institution, into which all bonded contract revenues (and any funds advanced by the surety) are deposited. The trust account so established is sometimes coupled with the additional protective device of a zero balance account. The mechanical interplay of trust and zero balance accounts is ably described elsewhere by no less than Judge Robert Bork.<sup>5</sup>

## II. TRUST FORMATION

It may be said generally that trusts are creatures of state law, and the creation of a valid and enforceable trust is therefore a function of compliance with the applicable state law.

A survey of cases involving sureties indicate great similarities among the states in the requirements for successful imposition of a trust on bonded contracts revenues and related funds. While the emphasis may vary on the components of a successfully established trust, the general requirements can be broadly stated as follows: there must be an express agreement which identifies (1) the trust beneficiaries, (2) the trustee, and (3) the trust res; and (4) which provides for or results in actual delivery of the trust corpus.<sup>6</sup> Other states place emphasis on the existence of “clear and convincing evidence” of the parties’ intention to create a trust.<sup>7</sup> This latter requirement would seem best satisfied by word and deed - a written agreement establishing a trust followed by a course of conduct consistent with the trust language of the agreement.

The prudent surety lawyer will in any event examine the substantive state law of the appropriate jurisdiction before manuscripting a trust agreement for a financing arrangement. As previously suggested, a surety lawyer might even converse with his estate planning partner during this process.<sup>8</sup>

Properly crafted, the surety's trust agreement should be effective even against a bankruptcy trustee. Stated simply: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under nonbankruptcy law is enforceable in a case under this title."<sup>9</sup> Trusts are valid and enforceable in bankruptcy proceedings if valid and enforceable under applicable state law.<sup>10</sup>

### III.

#### **DECISIONAL LAW ON ENFORCEABILITY OF TRUST AGREEMENTS**

Courts vary widely on their receptivity to the enforcement of trust agreements for the benefit of sureties and their interests. As will be seen below, inconsistencies exist even within the individual federal circuits and there is most certainly a wide array of bankruptcy decisions at the trial level. The source of these inconsistencies could be merely the imprecision of the judicial process; or, more cynically, could reflect hostility to compensated sureties or a preference for the interests of other classes of creditors.

The role of the surety lawyer - especially when drafting a manuscript trust agreement - is to anticipate the inconsistent and varying requirements imposed by courts for the establishment of a valid and enforceable trust, and to deal contractually with those requirements in the document executed by the parties. This role optimally extends beyond the mere drafting process, however, and should even encompass efforts to assure that the actions of both principal and surety are consistent with the provisions of the parties' trust agreement.

While the analysis herein does not purport to be exhaustive, we believe that the cases considered provide a useful guide in drafting an enforceable trust agreement, and in defending trust arrangements in a negotiation or litigation context.

#### A. Trust Agreements Held to be Enforceable

In less than five years the Sixth Circuit Court of Appeals managed to generate two well-known decisions on trust agreements which are at least inconsistent, if not wholly irreconcilable.<sup>11</sup>

Ruling in favor of the surety was Federal Insurance Company vs. Fifth Third Bank.<sup>12</sup> The surety on a general contractor's performance bond brought an action alleging that a bank had wrongfully offset two deposits made by the principal, where these deposits were the proceeds of progress payments. While the bank argued that it had the right to offset these deposits against sums which the principal owed to the bank in connection with other loans, the surety asserted that it had a trust interest superior to the bank's offset rights. The court looked to Ohio's adherence to the "equitable rule" and its emphasis on the intention of the parties, and held that the bank could not exercise set-off rights against deposits to reduce a general debt where it had at least

constructive knowledge as to the true nature of the payments, and therefore could not reasonably rely on these payments to change its position.

The contractual provision purporting to create a trust read as follows:

all moneys paid on account to any contractor for materials or labor shall be regarded as fund[sic] in his trust for payment of any and all obligations relating to this contract and no such amount of moneys shall be permitted to accrue to the contractor until all such obligations are satisfied. Evidence satisfactory to the state may be required to show that all current obligations relating to this work are satisfied before releasing any payment due on the work. Before payment on the final estimate, each contractor shall file an affidavit with the state, stating that monetary obligations relating to alienable items in connection with the work have been fulfilled. <sup>13</sup>

Looking to Ohio law, which requires “clear and convincing evidence” that the parties intended to create a trust, the court noted that “[i]f the intention is that the money shall be kept or used as a separate fund for the benefit of the payor, or a third person, a trust is created. If the intention is that the person receiving the money shall have the unrestricted use thereof, being liable to pay a similar amount whether with or without interest to the payor or to a third person, a debt is created.” In light of the control over the money given to the *owner* by the above contract language, the court held that a trust was formed.

While not involving a surety, In re Marrs-Winn Co., Inc.<sup>14</sup> provides useful guidance. There a subcontractor received financing from a creditor after filing a chapter 11 petition. The financing was extended in order to allow the subcontractor to complete certain work it was contractually obligated to perform, and was approved by the bankruptcy court. However, when the debtor’s account began receiving proceeds, the creditor withdrew these proceeds from the account for repayment of the debt. The debtor-subcontractor, as well as the contractor, brought suit to recover these funds, claiming they were for the benefit of the subcontractor’s materialmen and vendors.

To determine whether a trust existed, the court looked to the contract between the contractor and the debtor-subcontractor, from which these proceeds had come. In that agreement, it was provided that the proceeds to the debtor-subcontractor were to be held “in Trust for the benefit of those furnishing work, labor, material, services, equipment, etc. to or through Subcontractor for the Subcontract work.”<sup>15</sup> The court turned to Missouri law, which holds that an express trust exists where the trust agreement identifies the beneficiaries, the trustees, the trust res, and when there is actual delivery of the trust corpus. It held that the language “those who furnished work, materials, services, equipment, etc. to or through subcontractor from contractor”<sup>16</sup> was sufficient to identify the beneficiaries, and the language “all funds received by subcontractor from contractor” sufficiently identified the trust res.

It is interesting to note that this conclusion was reached in spite of language from the bankruptcy court, in its approval of the post-petition financing, that the creditor had a first security interest in the funds and had authority to apply post chapter 11 receivables against the

debt. The Bankruptcy court noted that the security interest applied only to accounts in which the debtor had an equitable interest. Because the funds were designated in the prior contract (between the contractor and the subcontractor) as being for the express benefit of the materialmen and vendors, the subcontractor was deemed not to have a security interest in these funds.

A contractor in T&B Scottsdale Contractors, Inc. v. U.S.,<sup>17</sup> opened an account in the name of its subcontractor, and proceeded to deposit funds into the account for the benefit of the subcontractor's materialmen. When the subcontractor went bankrupt, the estate laid claim to the funds in this account. The court rejected the estate's claim, and determined that the funds were being held in constructive trust for the benefit of the materialmen. Significant to the court's decision was the fact that the contractor was the only party to deposit funds into the account, the account statements were sent to the contractor, and no funds were ever disbursed out of the account to the subcontractor. In addition, all disbursements out of the account required the joint signature of the contractor and the subcontractor.

In Chang v. Redding Bank of Commerce,<sup>18</sup> a bank set off funds deposited with it by a debtor contractor. The bank's actions were taken in reliance on a provision in its loan agreement with the debtor that provided the bank a right to offset funds in the event of a debtor default. After reiterating the requirements for the creation of a trust under California law (intention to create, trust res, lawful trust purpose, and an identifiable beneficiary), the court held a trust to exist where a contractor received funds from the owner with explicit instructions to use these funds to pay the subcontractors. Apparently critical to the court's decision was the fact that the contractor was not free to use the funds as its own. It may be a point of distinction to note that the trust res was an identifiable, certain amount, and that the principal was prohibited from commingling the trust funds with other, non-trust funds.

The court was then faced with the issue of whether the bank was forced to recognize the trust nature of these funds, which would necessarily reduce its discretion in the handling of these deposits. The bank asserted the proposition that nothing short of an express agreement between the payor and the bank would defeat the bank's right of set-off. The court disagreed, and held that if the bank had notice of the trust nature of these funds, it would be prohibited from setting off against these funds. That issue required a determination of fact.

A favorable decision for a surety was yielded up by a New Jersey bankruptcy court. In re Alcon Demolition, Inc.<sup>19</sup>. In this case, a contractor executed a general agreement of indemnity in favor of its surety, wherein it stated that:

it is expressly understood and declared that all moneys due or to become due under any contract or contracts covered by the Bond are trust funds, whether in the possession of [Debtor] or otherwise for the benefit of and for payment of all such obligations in connection with any such contract or contracts [the surety] would be liable for under any of said Bonds, for which said trust also inures to the benefit of [surety] for any liability of loss it may have to sustain under any said bonds, and this agreement and declaration shall also constitute notice of such trust."<sup>20</sup>

Looking to applicable state law, the court held that four elements must be present to establish an enforceable trust: intent, a trust res, an identifiable beneficiary, and a trustee. In light of these four factors, the court held that the above stated language sufficient to create a trust in favor of the surety. Specifically, the language “all moneys due or to become due” was deemed adequate to describe the trust res, the subcontractors were clearly identified as the beneficiaries, and the contractor was clearly identified as the trustee.

Another decision favorable to the surety is the Oregon bankruptcy decision In re Comcraft.<sup>21</sup> A surety brought suit alleging that its claim was superior to that of a secured creditor to funds paid by the obligee to the principal after the principal’s chapter 11 petition was filed. Looking to the applicable state law to determine the priority of competing claims, the court recognized that a surety’s lien rights are inherently superior in Oregon. However, the court did note an important distinction from the established caselaw. In this particular instance, the funds in question had not been retained by the project owner, but had been paid to the contractor. The court ruled the result was the same, saying that “a surety which is forced to pay a bond claim is subrogated to the subcontractor or materialmen’s claim against the contractor in existence immediately prior to the payment. The right subrogated to is the subcontractor’s claim against the contractor; payment of the funds by the owner to the contractor does not diminish that right.”<sup>22</sup> The court went on to note that the funds still held by the bankrupt principal were impressed with a constructive trust to make the payments, saying that

The doctrine of constructive trusts, as well as of equitable liens, has long been recognized by Oregon courts. . . because the contractor . . . had an obligation to pay the subcontractors out of the proceeds of [the] contract, and [surety], as subrogee to the subcontractors it paid, has an independent right to be paid from those funds, the funds in question, to the extent still held by the bankruptcy trustee, are impressed with a constructive trust to make such payments.<sup>23</sup>

The court also rejected the contention that, because the alleged “trust funds” had been commingled with other funds, they had already been expended (assuming a “first-in, first-out” method of tracing the funds). In order to preserve the trust funds, the court instead used the “lowest intermediate balance” tracing method, noting that the theory had evolved in the “equitable principals of trust” and was recognized in the Ninth circuit. <sup>24</sup>

#### B. Trust Agreements Held to be Unenforceable

Decided by the same circuit, In Re Construction Alternatives<sup>25</sup> provides a sharp contrast to Federal Insurance Company vs. Fifth Third Bank.<sup>26</sup> In this case the Sixth Circuit Court considered a case where a contractor had tax liens levied on it after executing an indemnity agreement which contained trust provisions. The principal and Internal Revenue Service asserted the government’s prior right to the funds. The surety asserted a claim under equitable subrogation and pursuant to the trust provisions of the indemnity agreement.

The language at issue in the trust provision read as follows:

[I]t is expressly understood and declared that all monies due and to become due under any contract or contracts covered by the Bonds are trust funds, whether in the possession of the Indemnitor or Indemnitors. . . or otherwise, for the benefit of any for payment of all such obligations in connection with any such contract or contracts for which surety . . . would be liable under any of said Bonds, which said trust also inures to the benefit of the Surety for any liability or loss it may have to sustain under any said Bonds, and this Agreement and declaration shall also constitute notice of such trust.<sup>27</sup>

After examining the criteria used in the Fifth Third Bank case, as discussed above (both cases looked to Ohio substantive law to determine whether there was a sufficient property interest to create a trust), the court held that there was no trust fund because there was no requirement that the alleged trust funds be kept in a separate account. Therefore, the court deemed that there was no trust corpus. The Internal Revenue Service prevailed. Interestingly the court made no mention of the fact that the Fifth Third Bank case specifically refused to require segregation of funds.

In re Wm. Cargile Contractor, Inc.<sup>28</sup> is as unfortunate for the surety as Construction Alternatives. In Cargile, the Bankruptcy Court considered explicit trust provisions appearing both in an indemnity agreement and a subcontract executed by the debtor-subcontractor.

A construction manager held funds which were clearly subject to the trust provisions of both the indemnity agreement and the subcontract. The trust provisions were virtually identical to those in Fifth Third Bank, supra. The debtor's Unsecured Creditors Committee claimed the funds as a general asset of the estate, where as the surety insisted that the moneys should be paid directly by the construction manager in satisfaction of project claims.

The Court made an unconvincing effort to distinguish the case from Fifth Third Bank, supra. A reading of the case reveals that the outcome is based, almost wholly, on "policy" considerations, since enforcing the trust agreement "would be contrary to the priority scheme set forth under state law and the Bankruptcy Code."<sup>29</sup>

In Georgia Pacific Corp. v. Sigma Service Corp.,<sup>30</sup> a contractor entered into a joint checking arrangement with the owner of a project and also executed a letter in which it informed the owner of its instructions to issue all checks to it jointly for the benefit of the relevant materialmen. As a result, it was alleged that a constructive trust was thereby established for the benefit of the subcontractors and materialmen.

The court rejected the argument, stating that

The stated purpose of the letter agreement was to assure the suppliers of prompt payment and to assure [the owner] that suppliers were paid. However, in the absence of any evidence that actions in reliance or other consideration made this agreement binding on (principal]. Its naked wording represents merely {principal's] unilateral agreement to have some of the proceeds contractually due it from [owner] made payable to it by joint checks. It places no affirmative duty upon {principal] in

relation to the suppliers, for instance, for [principal] is neither required to endorse the checks nor to transfer them immediately to the suppliers, nor is [principal] prohibited under the terms of the agreement from revoking its 'plan' as 'propose[d]' by the letter. Considering the burden upon the appellees to prove that a trust was created by which the funds owed to [principal] were nevertheless not property of its bankruptcy estate, we are unable to find from the letter agreement itself, solely relied upon by the appellees, that [principal] and [owner] mutually agreed that [principal's] suppliers should receive any non-revocable funds due by [owner] to [principal].<sup>31</sup>

In Capitol Indem. Corp. v. U.S.<sup>32</sup> a contractor executed an indemnity agreement which purported to create a trust in the contract funds in favor of the surety. In the case the IRS attempted to levy on the proceeds, and the argument was made that the contractor no longer had an equitable interest to which any lien could attach.

The applicable contract language stated that, "contractor shall pay each subcontractor, upon receipt of payment from the owner, an amount equal to the percentage of completion allowed to the contractor on account of such subcontractor work."<sup>33</sup>

The court held such language to be insufficient to create a trust, on the grounds that it did not manifest an intent to create a trust, but simply indicated that payment to the subcontractors was the responsibility of the contractor rather than the owner. In addition, the language did not create a trust corpus, as the contractor was not required to pay the subcontractor out of specific funds or to "turn over portions of the progress payments directly."<sup>34</sup> Rather, the contractor only had an obligation to pay the subcontractors after receiving payment from the owner. As a matter of fact, a separate provision explicitly stated that, "neither the owner nor the architect shall have any obligation to pay or to see to the payment of any moneys to any subcontractors except as may otherwise be required by law."<sup>35</sup> In reaching its decision, the court relied on Illinois law holding that segregation of funds is critical to the creation of a trust. Finally, the court looked at the language in the indemnity agreement attempting to create the trust with suspicion, since it was found only in the boilerplate language.<sup>36</sup>

Bank One, Texas v. Highlands Insurance Company, et al.<sup>37</sup> is a decision highly favorable to sureties and warrants careful reading. The final trust agreement executed by the parties was extensively referenced by the court and, while not explicitly a part of the decision's final holding, was quite clearly a factor in the surety's favorable result.

For purposes of this paper the interesting feature of this case is an interim or temporary trust agreement executed by the parties pending final documentation. This interim agreement, which was little more than a letter of intent, appeared to give a non-party secured creditor of the debtor some rights against the deposited funds. Even though the interim agreement was quickly superseded by final documentation, the secured creditor subsequently attempted to assert recovery rights under the earlier document.

Under the terms of the interim trust document, the surety agreed to provide certain sums of money to the principal, and in exchange the principal agreed to "take whatever action is

necessary to require that all contract proceeds on the [principal] bonded contracts which are paid to principal be deposited in a trust account to be established in a form to be satisfactory to [surety] and [bank].<sup>38</sup> The court held that after payment of the money by surety, all of its obligations had been fulfilled, and no trust obligations were imposed on surety, particularly as to any alleged obligation to hold any funds in trust for the benefit of the bank. Neither was the bank held to any of these trust provisions, since it neither signed the agreement nor was a third party beneficiary of it.

While not a surety case, consideration of Mauriceville National Bank v. Zernial<sup>39</sup> is useful in structuring a relationship with the depository institution in a trust arrangement. The Mauriceville National Bank was sued for conversion for wrongfully offsetting a depositor's funds to pay other obligations which the depositor owed to the bank. Because of the bank's knowledge (after deposit) that the funds were to be used for the payment of the depositor's subcontractors and materialmen, the court of appeals held that the funds were "trust-like" in nature. Therefore, the court held that the bank had an obligation to segregate these funds from those funds that belonged to the debtor before offsetting these funds.

In overturning the Court of Appeals' decision, the Texas Supreme Court *agreed* that a bank with knowledge of the trust character of funds could not offset these funds. The court's *disagreement* was with whether or not a trust had ever been created. The court ruled that

Generally, when a depositor deposits funds into a bank account, those funds are unrestricted. The bank's obligation is to pay those funds back pursuant to the depositor's instructions. Such funds, however, are subject to the bank's right of setoff. In this case, the bank also had a contractual right of setoff under the security agreement. Furthermore, [the depositor] directed the bank to use the funds to set off his overdue payments. All of these establish the bank's right to set off these particular funds. A third party cannot unilaterally change a debtor-creditor relationship into a trustee-beneficiary relationship, and change the nature of deposited funds from unrestricted to restricted funds.<sup>40</sup>

The court went on to note that there was no evidence here of a pre-deposit agreement between the depositor and the bank, and no evidence that the bank knew of any trust arrangement prior to the deposit of the funds. Therefore, at least as to the bank, the funds were not trust funds.

### C. Trust Agreement Enforceable; Surety Still Loses!

American Employers Insurance Company vs. American Security Bank,<sup>41</sup> in an opinion written by Judge Bork, presents an interesting win-lose proposition for the surety. The trust agreement was held enforceable, but the surety nonetheless lost.

In this case, the surety made use of a depository institution which held a security interest in its principal's accounts receivable. The trust agreement provided that funds deposited into the account which represented surpluses over completion costs on specific bonded contracts would be subject to the bank's security interest. The surety also perfected a security interest in accounts receivable.

When it was discovered that the bank had failed to properly perfect its security interest, the surety (who was properly perfected) made claim against the "surplus" funds on the theory that its perfected security interest took priority over the bank's unperfected position. Presumably the bank thought the surety's position opportunistic, whereas we surety attorneys would view it as simply good lawyering.

In any event, the Court held that the trust agreement was clearly enforceable, and much to the surety's detriment. The case turned on the state law proposition that under the Uniform Commercial Code the surety's actual knowledge of the bank's security interest - even if improperly perfected - would result in a subordination of the surety's perfected interest.

This case is interesting for a variety of reasons. First, the depository bank was an actual party to the trust agreement and the result was a hybrid document that was part trust agreement and part intercreditor agreement. Had the surety been more keenly focused on the intercreditor features of the agreement it might have obtained affirmative representations from the bank as to its perfected position. These affirmative representations might have excluded the parole evidence which operated to the surety's ultimate disadvantage at trial; they might have resulted in the bank's proper perfection of its security interest; or, they might have resulted in a disposition of the "surplus" proceeds without litigation.

Second, the case demonstrates the inherent dangers in establishing an account, trust or otherwise, with a depository institution which is also a creditor of the bond principal. The bank apparently prevailed as to the "surplus" funds because of the court's conclusion that the surety had actual knowledge of the bank's security interest; but there is more than a hint in the opinion that the surety's course of dealing with the bank was a factor in the surety's loss of the surplus funds. It is difficult to imagine the surety losing this case if, for example, the depository institution had been a complete stranger to the principal, or a mere assignee of another bank's collateral position.

#### **IV.**

#### **PRACTICE AND DRAFTING NOTES**

The cases make clear that course of conduct is almost as important as the text of the trust agreement itself. Thus, while the surety lawyer may be able to do very little about the agreement's text when relying on a printed indemnity agreement, counsel may have an opportunity to shape the parties' conduct in a manner which enhances the prospect for enforceability. For example: assurance that the funds disbursed are used for the express purpose of the trust; segregation of funds, or at a minimum the ability of ready identification; and clear notice to the depository institution of the trust account's purpose.

When drafting a manuscript trust agreement primary emphasis should be placed on the requisite constituents of a valid state law trust in the appropriate jurisdiction. While the necessary components are similar in each state, individual state law requirements should always be examined.

Care should be taken in using a depository institution that is also a creditor of the principal. A strict prohibition is inappropriate, since the account relationship may facilitate resolution of other intercreditor issues between bank and surety. When using such a bank, however, the trust agreement should clearly subordinate the bank's security interests and setoff rights (including those contained in standard depository agreements) to the purposes of the trust and the surety's equitable subrogation rights.

Finally, a trust agreement should not be confused with an intercreditor agreement with the principal's bank. The cases make clear that the interests of all parties are best served by the separation of trust and intercreditor issues.

## **V. CONCLUSION**

Whether included in an indemnity agreement or specially manuscripted, the trust agreement remains a viable mechanism for the protection of bonded contract proceeds. Of course, sureties can anticipate continued hostility to trust arrangements from many sources for "policy" and other reasons. When presented with the opportunity, careful drafting followed by conduct consistent with the agreement provides a good defense.

1. Timothy J. Burson, "Joint Control, No Control, Out of Control," presentation to the Ninth Annual Southern Surety & Fidelity Claims Conference, Atlanta, Georgia (1998).

2. Jacqueline T. Lewis, J. Michael Franks, and John H. Rowland, *Prepetition Planning for Contract Sureties*, THE CONSTRUCTION LAWYER, August 1995, at 41 (1995).

3. FIFTY STATE CONSTRUCTION LIEN AND BOND LAW (Robert F. Cushman, ed., 1992).

4. Sample trust language includes the following:

All payments received for or on account of any contract shall be held in a trust fund to assure the payment of obligations incurred or to be incurred and the performance of any contract and for labor, materials, and services furnished in the prosecution of the work in any contract or any extension or modification thereof. All moneys due or to become due under any contract are also trust funds, whether in the possession of principal, indemnitors or otherwise. The trust fund shall be for the benefit and payment of all obligations for which surety maybe liable under any bonds. The trust funds shall inure to the benefit of surety for any liability or loss it may have or sustain under any bond, and this agreement and declaration constitute notice of such trust. The trust funds, unless otherwise restricted or regulated by state or local laws, can be co-mingled with other funds, but the trust fund nature and purpose as stated in this paragraph shall not be modified nor waived by this co-mingling provision.

[The undersigned] agrees that the entire contract price of any contract referred to in a bond or bonds, whether in the possession of the undersigned or another, shall be and hereby is impressed with a trust in favor of surety for the payment of obligations incurred for labor, materials and services in the performance of the contract work for which surety would be liable under such bond or bonds and for the purpose of satisfying the conditions of the bond executed in connection with the contract.

If any of the bonds are executed in connection with a contract which by its terms or by law prohibits the assignment of the contract price, or any part thereof, the contractor and indemnitors covenant and agree that all payments received for or on account of said contract shall be held as a trust fund in which the surety has an interest, for the payment of obligations incurred in the performance of the contract and for labor, materials, and services furnished in the prosecution of the work provided in said contract or any authorized extension or modification thereof; and further, it expressly understood and declared that all moneys due and to become due under any contract or contracts covered by the bonds are trust funds, whether in the possession of the contractor or indemnitors or otherwise, for the benefit of and for payment of all such obligations in connection with any such contract or contracts for which the surety would be liable under any of said bonds, which said trust also inures to the benefit of the surety for any liability or loss it may have or sustain under any said bonds, and this agreement and declaration shall also constitute notice of such trust.

5. American Employers Ins. Co. v. American Security Bank, N.A., 747 F.2d 1493, 1495-97 (D.C. Cir. 1984).

6. In re Marrs-Winn Co., Inc., 193 B.R. 491, (C.D. Ill. 1996), *aff'd*, 103 F.3d 584 (7<sup>th</sup> Cir. 1996).

7. Federal Ins. Co. v. Fifth Third Bank, 867 F.2d 330, 333 (6<sup>th</sup> Cir. 1989).

8. Lewis et al., *supra.* note 2, at 43.

9. 11 U.S.C.S. §541 (1997).

10. WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2D §51:16 (1997).
11. Federal Ins. Co. v. Fifth Third Bank, 867 F.2d 330 (6<sup>th</sup> Cir. 1989); In re Construction Alternatives, Inc., 2 F.3d 670 (6<sup>th</sup> Cir. 1993).
12. 867 F.2d 330.
13. Id. at 332.
14. 193 B.R. 491, (C.D. Ill. 1996), *aff'd*, 103 F.3d 584 (7<sup>th</sup> Cir. 1996).
15. Id. at 498.
16. Id.
17. 866 F.2d 1372 (11<sup>th</sup> Cir. 1989), *reh'g denied en banc*, 873 F.2d 300 (11<sup>th</sup> Cir. 1989), and *cert. denied*, 493 U.S. 846 (1989).
18. 29 Cal. App. 4<sup>th</sup> 673, *review denied*, 1995 Cal. LEXIS 601 (Feb. 2, 1995).
19. 204 B.R. 440 (Bankr. D. N.J. 1997).
20. Id. at 448.
21. 206 B.R. 551 (Bankr. D. Or. 1997).
22. Id. at 554.
23. Id. at 555.
24. Id. at 555-56.
25. 2 F.3d 670 (6<sup>th</sup> Cir. 1993).
26. 867 F.2d 330 (6<sup>th</sup> Cir. 1989).
27. In re Construction Alternatives, Inc. 2 F.3d at 676.
28. 151 B.R. 854 (Bankr. S.D. Ohio 1993).
29. Id. at 859.
30. 712 F.2d 962 (5<sup>th</sup> Cir. 1983).
31. Id. at 971.
32. 41 F.3d 320 (7<sup>th</sup> Cir. 1994) *cert. denied*, 515 U.S. 1144 (1995).
33. Id. at 323.
34. Id. at 324.
35. Id.
36. Id.
37. No. 04-95-00Z01-CV, 1996 Tex. App. LEXIS 4986 (Nov. 13, 1996).
38. Id. at \*25-26.

39. 892 S.W.2d 858 (Tex. 1995).
40. Id. at 860.
41. 747 F.2d 1493 (D.C. Cir. 1984), *cert. denied*, 510 U.S. 867 (1993).