



CONSTRUCTION LAW E-UPDATE

GETTING PAID: HAVE YOUR MECHANIC'S LIEN RIGHTS EXPIRED? You May Still Have “Bullets in the Clip”

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The fundamental need of all subcontractors, regardless of their size or trade, is to be timely paid for work performed. Subcontractors too often forego many of the rights the New York Lien Law affords them. You must keep in mind that the Lien Law provides subcontractors with many weapons **beyond** mechanic's lien rights.

Not Just Mechanic's Liens

Most subcontractors are quite familiar with all the varying filing dates and deadlines for mechanic's liens. However, subcontractors may allow their mechanic's lien rights to expire for what seems like a good reason at the time (e.g., preserving their relationship with a general contractor or owner) or a bad reason (e.g., missing a critical date). More often than not, a subcontractor which has lost its mechanic's lien rights often believes that it is then relegated to an expensive and time consuming lawsuit against the general contractor and/or the GC's payment bond surety on a “bonded” job.

However, there is another major section of the New York Lien Law that is “chock full” of other weapons specifically designed by the New York Legislature to be of assistance to subcontractors and suppliers.

Article 3A

Many subcontractors mistakenly believe that the so-called “trust provisions” under Article 3A of the Lien Law are only afforded to those subcontractors who have filed a mechanic's lien. This remedy, while codified as part of the Lien Law, is,

in fact, not dependent upon the filing of a mechanic's lien or even having mechanic's lien rights still being available. The provisions of Article 3A are in **addition** to, and separate and apart from, a subcontractor's independent mechanic's lien rights. In the hands of knowledgeable counsel, we have seen such provisions produce huge dividends, often after other valuable Mechanic's Lien Law rights have long expired.

Under Article 3A, **all** contract funds which come into the possession of a general contractor from an owner are deemed “trust funds” and must be used, first, to pay for labor and materials on the project before any other disbursements are made (e.g., profit distributions by the general contractor). A contractor cannot use those funds to pay itself, or to pay its obligations on **any** other project (i.e. “robbing Peter to pay Paul”), until **all** subcontractors and suppliers have been paid in full on the job from which those funds originated. Trust funds must flow “vertically” on a project, and **never** flow “horizontally” to meet other needs of a general contractor on other projects. Also, contrary to another misnomer in the industry, the trust fund provisions apply to **both** public and private jobs.

In addition to compelling a general contractor to disgorge any funds he may have improperly diverted, Article 3A imposes **personal** liability and criminal sanctions upon the individual principal(s) of the general contractor for diverting trust funds. Under the N.Y. Penal Law Sections 165.40 et seq., such a diversion would constitute larceny. The mere possibility of personal liability and/or a criminal investigation for the

diversion of contract funds often proves to be a driving force in the settlement of a payment dispute.

Right to Accounting

Lien Law Article 3A also allows the subcontractor to demand an immediate (within 10 days) inspection of the contractor's books and records. Under the trust fund provisions of the statute, a trust fund beneficiary, such as a subcontractor or material supplier, may examine the books and records of the owner or contractor, or in the alternative, demand a written statement under oath setting forth an itemized accounting of **all** monies received and **every** expenditure paid on the project, identifying the purpose of each payment, to whom it was paid, and when it was paid. The beneficiary may demand such an inspection, or an itemized statement, repeatedly, on a monthly basis, if necessary, and, again, that demand must be complied with within 10 days of its receipt. If the trustee (general contractor) refuses or fails to timely comply with the demand for the inspection, the beneficiary may seek a court order to compel the production of these records. Applications for such an order are readily and promptly granted by New York courts.

While Article 3A does not require the contractor to maintain separate bank accounts for each job, it does require the contractor to be able to provide a subcontractor with a separate accounting for each project including: (a) an itemized list of all funds received by the contractor on that given job, (b) an itemized list of all payables on that job; and (c) an itemized list of all payments made on that job. Article 3A requires the contractor, upon being served with a demand, to provide the subcontractor with a verified (sworn) statement as to the entries in the contractor's books and records. This verified statement also must be served upon the subcontractor within 10 days from receipt of the demand.

As to a practical point, Article 3A provides the subcontractor with an option. He may either demand the itemized statement, or he can demand to physically inspect the contractor's books and records themselves and take whatever notes or copy whatever entries it deems necessary. I have **never** seen a general contractor interested in having a subcontractor or supplier come to its offices and search through its records. This alone is a potent threat.

Pursue Collection

The subcontractor, as trust fund beneficiary, must act promptly to preserve its rights under Article 3A. Any action to enforce the trust fund must be commenced against the general contractor within one year from completion of the project.

G&C Commentary

In order to maximize its efforts to collect all monies it has earned, it is critical that a subcontractor know and **utilize** all payment enforcement tools afforded it under the law. Article 3A of the New York Lien Law, the "Construction Trust Fund Statute," provides powerful, relatively inexpensive tools for collecting money for labor performed or materials supplied on a construction project. At times, this may be the **only** source of recovery where mechanic's lien and/or payment bond rights are no longer available. In the hands of knowledgeable subcontractors, these could present potent, cost-effective weapons.

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