The Subcontractor's "Sword & Shield"

Lien Law § 76 and § 38

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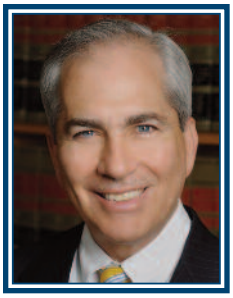

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Timely collection of receivables, especially in times of economic uncertainty, is often the difference between success and failure for the subcontractor. Managing the costs associated with collecting those receivables is of additional concern. Thankfully, the subcontractor has use of New York's Lien Law as its "sword and a shield" to facilitate the collection process.

The Lien Law can assist the subcontractor in two ways. First, as an extremely effective "sword", offensively, (Lien Law § 76) in an effort to collect its receivables and, secondly, as a "shield", defensively, (Lien Law § 38) in an effort to protect its Mechanic's Lien. This valuable statute provides effective tools that subcontractors can routinely utilize in managing their delinquent accounts.

The Sword

Section 76 of the Lien Law provides a subcontractor with a powerful weapon which often leads to the prompt resolution of receivables. While § 76 appears in the Lien Law, there is no requirement that a Mechanic's Lien be filed in order for a subcontractor to take full advantage of § 76. A subcontractor, in fact, may utilize § 76 without ever filing a mechanic's lien. Under Article 3A of the Lien Law (which includes § 76) all funds paid to the general contractor are deemed "trust funds" and must be utilized first to pay the subcontractors and suppliers before the general contractor can use those funds for non-project specific expenses.

Section 76 provides that if a subcontractor has not been paid for more than thirty (30) days it may serve upon the general contractor a demand under § 76, which requires the contractor to provide the subcontractor with an itemization of all the funds it has received on that project and where those funds were spent, essentially an audit.

This requirement to account is not limited to funds the contractor receives on behalf of the complaining subcontractor. Often general contractors will attempt to limit their disclosure to only those funds it received on behalf of the work performed by the complaining subcontractor. However, the general contractor must provide detailed responses relating to all funds it has received from the owner.

Further, § 76 provides that at the subcontractor's option, in lieu of a written itemized statement, the subcontractor may demand to inspect the general contractor's books and records personally. I would imagine that very few general contractors would like their subcontractors to examine their books and records. Such accounting may bring to light a reality of the industry. Unfortunately, it is not uncommon for a general contractor to use the funds of one project to keep another project afloat. As such, the general contractor may, instead of opening this Pandora's box, opt to simply resolve the outstanding account.

The Shield

Section 38 of the Lien Law requires a lienor upon being served with a demand to provide the general contractor with an itemized statement as to the materials furnished and the labor provided which make up the amount of the lien. The purpose of § 38 is to enable the general contractor to investigate and verify the subcontractor's demand for payment that a Mechanic's Lien represents. Section 38 requires the lienor to set forth a detailed description of the materials, the quantity and the costs of those various materials as well as a description of the labor furnished, time spent and the hourly rate.

This is the shield, a detailed explanation of the sums due. It should buttress and support the Mechanic's Lien and be used as an opportunity to protect it from attack.

Interestingly, there is a misnomer which is created by § 38 itself that a general contractor has an absolute right to a § 38 statement. This is not so. The purpose of the itemized statement as previously stated is to provide the general contractor with a detailed breakdown of the claim so that he can investigate and verify that claim. When the lien amount is based upon a lump sum contract, however, the contract itself contains the details of the labor and material to be provided. There is no purpose served by requiring the lienor to serve what would amount to a redundant itemized statement. As such, the lienor is not required to do so.

If, however, as is more common, the lien amount includes not only base contract funds, but extras or change orders which may not have been approved. In that case, the lienor need only itemize that labor and material which relates to the disputed work (extras and unapproved change orders). There is no need for an itemization of the base contract portion of the claim.

Goldberg & Connolly Commentary

By knowing its rights and responsibilities under § 76 & § 38 of the Lien Law, a subcontractor can increase its chances of collecting its receivables while at the same time minimizing the time and costs it has to incur in order to collect those receivables.

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