

NEW YORK LIEN LAW'S "TRUST FUND" PROVISIONS PROVIDE POTENT WEAPONS TO UNPAID CLAIMANTS

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New York law provides a harsh penalty for owners, general contractors, and sub-contractors, on both public and private construction projects, who use monies from one project to pay creditors on other projects or use the monies for their own purposes. The owner, general contractor or subcontractor who "diverts" project funds for purposes other than paying labor and material claims on that particular project is subject to civil liability and criminal penalties. Under the New York Penal Law, such a diversion would constitute a larceny.

The construction trust fund statutes declare that monies, such as a building loan received by an owner of a project, or monies paid by the owner to a general contractor, as well as monies paid by a contractor to a subcontractor, are trust assets held by them as trustees to be used for payment to those performing work or supplying materials on their behalf on the project. (If an owner provides his/her own capital for construction to the project, the sum is not deemed a trust asset.) It is important to note that one can be a trust beneficiary whether or not one has filed a mechanic's lien. The purpose of the trust fund statutes is to assure that payment of project funds are properly made for all labor and materials furnished in connection with the project before any other disbursements are made (e.g., profit distributions by the general contractor).

Personal Liability

A company which receives trust funds and pays them to anyone other than job claimants does so through the action of its agents. Such a diversion of trust assets make the corporate officers, directors and agents who actively engage in the known diversion personally liable to the unpaid claimants on that project. New York State case law holds that the personal liability of corporate officers for diversion of trust funds is not dischargeable in bankruptcy.

Right to an Accounting

Under the trust fund provisions of the statute, a trust beneficiary, such as a general contractor, 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 made 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 itemized statement every month, and that demand must be complied with within 10 days from receipt of the demand. If the trustee refuses or fails to comply with the demand to inspect the trustees records within the 10 days the beneficiary may seek a court order to compel the production of these records. A motion by a beneficiary to compel production of the trustees records may be made on three days notice instead of the usual eight days notice. This right to examine books and records is unqualified. A trust beneficiary, may readily obtain a court order to compel the accounting. Failure to comply with the court order subjects the contractor or owner to a citation for contempt of court.

Subcontractors as well have the same trust obligations to parties they employ or with whom they contract with respect to monies received from a general contractor on a project. An unpaid sub-subcontractor or material supplier has a right to demand an accounting of a subcontractor to determine whether trust funds were diverted from the project.

The right to an accounting cannot be defeated by arguing that the unpaid claimant has inadequately performed his work or that the work was not satisfactorily completed. The courts will not inquire into the merits of whether the money is actually due to the unpaid claimant.

A corollary to the right to an accounting is the statutes requirement for trustees to maintain accurate records of the trust accounts. Failure to maintain such records is presumptive evidence that the trustee has diverted trust funds by permitting payments from the trust for some other purpose than trust purposes. In practice, this means all contractors and subcontracts must keep accurate, project-specific records. There need not be a separate bank account for each project, but there must be a separate accounting.

Class Action

The trust fund beneficiary must join with all other beneficiaries in a class action to enforce the trust, seek an accounting, and recoup any diverted monies. This action may be brought at any time during the project. However, the action can not be maintained if more than one year has elapsed since the completion of the project.

In the case of material men and subcontractors there is added protection to ensure payment. They are afforded the choice of the project completion date or an alternative of one year from the date on which final payment under their contract became due, whichever is later.

G&C Commentary

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 rights are not available or the claimant is not protected under a labor and material payment bond. At other times, the Article 3A trust fund provisions can be used very effectively in conjunction with mechanic lien rights.