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## **New York Lien Law article 3-A: Contractors beware of failure to abide by the provisions - by Jeffrey Lhuillier**

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The growing frequency in which subcontractors, laborers and material suppliers have not been paid for labor and materials provided to a project has resulted in the enactment of New York's Lien Law Article 3-A. Under Article 3-A, any funds received by an owner, general contractor, or sometimes even subcontractors, are treated as trust funds and therefore obligate the trustee of said funds to act as a fiduciary to ensure payment to subcontractors, material suppliers and laborers.

It is important to understand under what circumstances a trust is created and what funds are to be held as trust funds. Pursuant to New York Lien Law §70(6), the assets of the trust of which a contractor is trustee are the funds received by him and his rights of action for payment thereof (a) under the contract for improvement of real property, or home improvement or the public improvement; (b) under an assignment of funds due or earned or to become due or earned under the contract; or (c) as proceeds of any insurance payable because of destruction of the improvement of real property including a home improvement or public improvement or its removal by fire or other casualty. More simply, a trust fund is created under Lien Law Article 3-A out of the payments or funds received by owners or contractors for labor and materials supplied to a project. A trust commences when any asset comes into existence, whether or not at that time there are beneficiaries to the trust, and will continue until every asset of the trust or every trust claim arising at any time prior to completion of the contract has been paid or discharged, or until all assets have been applied for the purposes of the trust. Lien Law §70(3).

The purpose of Article 3-A is to ensure that those who directly expend labor and materials to improve real property at the direct of an owner or contractor ultimately receive payment for the work they performed. *Broadway Houston Mack Dev., LLC v. Kohl*, 71 A.D.3d 937, 897 New YorkS.2d 505 (2010). The funds received by an owner or contractor in connection with an improvement to real property in the State of New York, as well as any right of action for any such funds due, or earned, constitute assets of a trust. New York Lien Law § 70. Likewise, those persons or entities that have claims for payment from a trust fund of which a trustee is authorized to use trust assets are known as beneficiaries of the trust, regardless of whether or not they have filed or have the right to file a mechanic's lien pursuant to New York's Lien Law. New York Lien Law § 71(4). As a result, owners and contractors are trustees for the benefit of subcontractors, material suppliers and laborers. *Martirano Const. Corp. v. Briar Contracting Corp.*, 104 A.D.2d 1028, 481 New YorkS.2d 105 (1984). It is very important for trustees of a trust fund to understand their obligations under to New York's Lien Law, as a failure to abide by the Lien Law could spell trouble. First, pursuant to New York Lien Law § 75, a trustee's books and records must be maintained with entries, including accounts payable, assets received, payments made with trust assets, and transfers in repayment of or to secure advances made pursuant to a notice of lending. Trustees may be served with an application for a request to examine or provide a verified statement as to the trust. If the trustee refuses or fails to comply within ten of the date of the request, a beneficiary may apply to the court for an order directing the trustee to comply. New York Lien Law § 76(5). Second, the assets of a trust are to be held and applied to certain specific payments, such as certain expenditures including payments of claims, payment of the amount of taxes based on payroll, payment of unemployment insurance, benefits and wage supplements, payment on premiums on surety bonds or bonds filed and premiums on insurance and payments to which the owner is entitled. New York Lien Law § 71(2).

A trustee may find themselves in hot water should they fail to apply trust assets to the allowable expenditures under the lien law. Any trustee of the trust that applies or consents to the application of

trust funds for any other purpose other than for the purpose of the trust is guilty of larceny and punishable as provided by the penal law. New York Lien Law § 79-a. For example, the alleged conduct of owner in making unauthorized disbursements of Lien Law trust assets to its partners without satisfying the claims of contractors, subcontractors and suppliers, if established, would constitute larceny and would satisfy the high threshold of moral culpability necessary to support a punitive damages award. *Sabol & Rice, Inc. v. Poughkeepsie Galleria Co.*, 175 A.D.2d 555, 572 New YorkS.2d 811 (1991). As such, contractors beware, as a failure to abide by provisions of Article 3-A runs the risk of punishment under the penal law and possible punitive damages.

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