

# New York Law Journal

## Real Estate Trends

WWW.NYLJ.COM

VOLUME 260—NO. 94

An **ALM** Publication

WEDNESDAY, NOVEMBER 14, 2018

### CONSTRUCTION LAW

# An Owner's Response To Potential Subcontractor Liens



By  
**Kenneth M.  
Block**



And  
**Joshua M.  
Levy**

**C**onsider this scenario: Your client is the owner of a construction project nearing completion when she is approached by her general contractor and told that he owes more money to his subcontractor than she owes (or will owe) to him. To add to the distress, a mechanic's lien has been filed by one of his subcontractors and your client is concerned that additional liens may be filed. What are your client's options if she does not wish to increase the contract sum and continue working with the general contractor?

Addressing your client's concern regarding existing and future liens, it must first be noted that while the unpaid subcontractors can file notices of lien for the full amount owed by the general contractor,

the owner's liability for such liens is limited by the amount unpaid to the general contractor at the time of the filing of the liens. This unpaid amount is known as the "lien fund." Thus, in the absence of a lien fund, a lien by a subcontractor is invalid against an owner. In our scenario, however, your client has exposure to the previously filed lien because, at the time of the filing, monies were due to the general contractor.

### A Successful Approach

An approach we have successfully followed in these circumstances involved the consensual termination of the general contractor and the payment in full of all monies then due to the general contractor, subject to an escrow payment to its counsel to cover the cost of satisfying the existing lien. This approach allowed for a clean break with the general contractor and provided substantial

funds—trust funds under the Lien Law—for payment to the subcontractors and to cover permissible reimbursement for fee and general conditions to the general contractor. The general contractor, of course, remained liable to its subcontractors for any shortfalls due to the subcontractors.

In following this approach, we relied on the Lien Law and ancient common law principles that, in the absence of fraud, an owner cannot be compelled to pay any greater sum for the completion of a project than he has agreed to pay his general contractor, and that such payments cannot be attacked by subsequent lienors. Some two months after the owner settled in full with the general contractor, and extinguished the lien fund, a notice of mechanic's lien was filed by a subcontractor, followed by a lien foreclosure action which included claims for trust fund diversions against the general contractor. After extensive discovery,

---

KENNETH M. BLOCK and JOSHUA M. LEVY are members of Tannenbaum Helpert Syracuse & Hirschtritt, Hillel Sussman, an associate of the firm, contributed to the preparation of this article.

we moved to dismiss the action against the owner.

In opposition to our motion to dismiss, the subcontractor argued, among other things, that the owner had no right to, in effect, terminate the contract “for convenience,” as opposed to “for cause,” and that the final payment was actually an impermissible payment “in advance “ under Section 7 of the Lien Law. (“Any payment by the owner, contractor or subcontractor upon a contract for the improvement of real property, made prior to the time when, by the terms of the contract, such payment becomes due, for the purpose of avoiding the provisions of this article, shall be of no effect as against the lien of a subcontractor, laborer, or materialman under such contract, created before such payment actually becomes due.”)

Thus, the essential question for the court was whether the owner had the right to terminate the general contract for convenience and make final payment upon such termination. In *3-G Services Limited v. Sap V/Atlas 845 WEA Associates NF LLC*, (2017 N.Y. Slip Op. 31593(U), [Sup Ct, NY County 2017]), the Supreme Court ruled for the owner.

In *3-G Services*, Justice Joan Madden held that under the specific facts presented, the lienor

would not be able to foreclose on its lien, even though the contractor was terminated for convenience prior to the final completion of the project. The contractual termination for convenience provision allowed the owner to terminate at any time, and the general contractor would only be entitled to monies due and owing for work performed as of that date. In affirming, the Appellate Division found that the final payment to the general

---

Your client is the owner of a construction project nearing completion when she is approached by her general contractor and told that he owes more money to his subcontractor than she will owe to him, and also a mechanic’s lien has been filed by one of his subcontractors. What are your client’s options if she doesn’t want to increase the contract sum and continue working with the general contractor?

contractor was not an advance payment under Section 7. *3-G Services Limited v. SAP V/Atlas 845 WEA Associates NF LLC*, aff’d, 162 A.D.3d 487 (1st Dept. 2018). The court also addressed the lienor’s arguments of bad faith and concluded that neither the owner’s knowledge that monies were due to the lienor nor its election to

terminate for convenience demonstrated bad faith.

### Back to the Scenario

Returning to our scenario, you first must reach agreement in concept with the general contractor regarding termination and final payment. Although the general contract may allow for termination for convenience, the general contractor may prefer a mutual termination. A final requisition should then be provided by the contractor and a lien search performed by the owner. Once the final amount has been agreed upon it can be paid in exchange for a final waiver and release of lien. To the extent that liens exist, a separate escrow should be established to facilitate payment.

As to the claims of the subcontractors, the final payment to the general contractor will be considered trust funds and the general contractor should provide an indemnity to the owner against such claims if one does not already exist in the general contract. While there are no guarantees, this course should protect the owner against liability for subsequently filed notices of lien.