



**CONSTRUCTION
PRACTICE GROUP**

The attorneys in Meltzer Lippe’s Construction Law Practice Group represent clients in all aspects of both private and public construction projects, including contract negotiations, responding to, resolving, and litigating claims and disputes during the project.

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NEW YORK APPELLATE COURT: GENERAL CONTRACTORS CANNOT REIMBURSE THEMSELVES FROM TRUST FUNDS BEFORE PAYING SUBCONTRACTORS AND SUPPLIERS

WARNING: General contractors that reimburse themselves for advances before subcontractors and suppliers get paid puts you at risk for claims of trust diversion.

Summary. In a recent decision, a New York appellate court held that contractors who pay subcontractors in advance of their receipt of payment cannot reimburse themselves until all downstream trust claims are fully satisfied. The ruling has implications that stand to significantly impact New York construction projects.

Background: The Lien Law’s Trust Fund Provisions. In addition to mechanics liens, New York’s Lien Law has a perhaps less known remedy –Article 3-A. Under Article 3-A, monies received in connection with a project are considered “trust funds.” The party receiving the “trust funds” (ie, the general contractor) is the “trustee” and its subcontractors, suppliers, and the like are its “beneficiaries.” Like other trusts, the trustee can only use trust funds for specific purposes, including paying “beneficiaries” such as subcontractors and suppliers *that performed work on the same project for which the contractor received the money.*

Well, what if a Lien Law Article 3-A trustee uses its own money to pay subcontractor or supplier claims while waiting to be paid? Can it repay itself when it receives payment from the owner or otherwise? Until recently, many assumed the answer was yes. A new appellate decision says otherwise.

The Decision. In *L.C. Whitford Co., Inc. v. Babcock & Wilcox Solar Energy, Inc.*, 244 A.D.3d 1552 (3d Dep’t 2025), the Third Department of New York’s Appellate Division addressed this question directly.

The case arose from a series of related construction projects. After terminating the projects, the projects’ owners settled with the general contractor. The general contractor’s subcontractors and suppliers claimed they were entitled to the proceeds of that settlement, but the general contractor took the position that it should first be allowed to reimburse itself for advances it had made to pay other subcontractor and supplier claims – which the general contractor claimed had exhausted the settlement funds.

The Third Department disagreed, holding that the settlement proceeds were Article 3-A trust funds and that the general contractor did not have a legal right to them until all trust claims were satisfied. That the general contractor had previously used its own money to pay subcontractors and suppliers in advance of receiving payment from the owners did not give it priority when the settlement funds arrived.

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Key Takeaways. The *L.C. Whitford* decision has concrete implications for contractors, subcontractors, and suppliers on New York construction projects:

For Lien Law Article 3-A Trustees:

- Avoid paying Article 3-A beneficiaries until you receive payment. If you pay downstream claims out of pocket while waiting to receive payment, you will not be able to reimburse yourself until all trust claims are satisfied. Doing so will subject you to claims of trust diversion, which, among other things, subjects the company and the individuals who authorize the payments within the company to civil **and criminal** liability.
 - Depending on the project, that could mean waiting until well after final closeout – or even never recovering if total trust claims exceed the funds you ultimately receive.
- Lien Law Article 3-A's "Notice of Lending" may provide a path forward. The Lien Law includes a procedure under which lenders can file "Notices of Lending" and collect repayments without being deemed to have diverted trust funds. Given the Third Department's logic in *L.C. Whitford*, this might present a path forward for those who need to advance funds to pay subcontractor and supplier claims. The law on this issue is unsettled, so be sure to consult counsel before proceeding.
- Ensure that your contracts include "pay-when-paid" language. New York prohibits "pay-if-paid" clauses, which means you cannot simply condition your payment obligation on receiving funds from the owner. However, "pay-when-paid" clauses, which allow you to reasonably fix the time of payment to your receipt of payment from the owner, are typically permitted. In light of the *L.C. Whitford* decision, "pay-when-paid" language is more crucial than ever, because without it you may be required to pay out of pocket and incur the associated risk of only being able to recoup this amount after all beneficiaries are fully paid.

For Lien Law Article 3-A Beneficiaries:

- Stay informed about owner-contractor disputes. Settlement funds can disappear quickly if other creditors or the general contractor itself makes claims against them. Monitor the status of any close-out or settlement discussions involving your projects and consult counsel promptly if you learn a settlement is imminent.
- Act before the statute of limitations runs. Article 3-A trust claims generally must be brought within one year of a project's completion. If a general contractor settles a dispute with the project owner, subcontractors who wait too long may lose the right to recover from those settlement proceeds – even if they would have had priority as a matter of law.

Meltzer, Lippe, Goldstein & Breitstone, LLP will continue to monitor this topic and provide updates regarding any further developments. Clients with questions or concerns are encouraged to contact Manny Frade at mfrade@meltzerlippe.com or Adam Wald at awald@meltzerlippe.com