

## **STATEMENT FROM STUART S. ZISHOLTZ**

Many contracts permit the owner to retain funds from each requisition submitted for payment by the contractor. This procedure allows the owner to insure completion of the project and all related punch list items.

As a subcontractor, the issue has always been when are they entitled to the retainage funds and how long do they have to wait.

The law in New York State is that a subcontractor does not have to wait for the General Contractor to receive payment from the owner. It is entitled to receive payment when the work it performed was completed and accepted. While certain time frames may be incorporated into a payment schedule, the “pay when paid” terms of a contract are illegal and unenforceable.

Retainage funds are similar in nature. The lien law has been amended to address the rights of a contractor to lien for retainage money. The funds are held back for work already performed by the subcontractor. They are used to compel the subcontractor to complete all work and related punch list items. At the close of the project and upon receipt of an architect’s certification, the final retainage funds can be released.

Recently, there was a decision rendered by the Appellate Division, First Department, where a subcontractor was not entitled to the retainage funds. In that particular case, the General Contractor was terminated for cause by the owner. The owner, after an arbitration proceeding, was awarded damages in excess of the retainage funds. As such, the owner was not obligated to release any of the retainage funds held by him at the completion of the project. Subsequently, an action was instituted by a subcontractor demanding payment by the owner under the trust provisions of the Lien Law. The claim was made that the retainage funds were trust funds for work already performed and cannot be used for any other purposes other than for paying

contractors and subcontractors who performed work and furnished materials on the project. The Court held that the retainage funds were never due the General Contractor and the General Contractor possessed no future right of action with respect to them. Therefore, there were never any assets to argue a diversion of trust funds. In addition, the Court held that a subcontractor is a beneficiary of trust assets received by the General Contractor or to which the General Contractor is entitled. Since the General Contractor was not entitled to any of the retainage funds held by the owner, there was no diversion of trust funds and there was no claim for which the subcontractor can pursue against the owner.

Retainage funds, therefore, is not a guarantee of payment in the future. In this particular instance, the subcontractor still had a claim against the General Contractor for breach of contract. However, if the General Contractor went out of business or took off with the retainage funds, the rights of the subcontractor are severely diminished.

Never let your lien time run out.

For a free copy of a pamphlet pertaining to Mechanic's Liens and Payment Bond Claims, feel free to contact me or the Association.

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