

STATEMENT FROM STUART S. ZISHOLTZ

Bankruptcy proceedings have always maintained a negative connotation in the construction industry. Most of the time when a General Contractor or a tenant files a bankruptcy proceeding, the subcontractors or suppliers close the file and write off the loss. Do not close your books so fast!

The Lien Law permits a subcontractor to file a Mechanic's Lien even after a General Contractor or a tenant files for bankruptcy. Moreover, the funds being held by the tenant or General Contractor are trust funds to be applied first for the payment of the contractors who performed work and furnished materials at the site. These trust funds, including retainage, are not part of the Bankruptcy Estate.

In order to protect yourself, a Proof of Claim should be filed in the Bankruptcy Court stating that the subcontractor is an Article 3-A beneficiary and a secured party. A mechanic's lien should also be incorporated with the Proof of Claim.

If the bankruptcy proceeding is large enough, there are a few options available to the subcontractors to address the trust fund violation. The Bankruptcy Code offers the appointment of a Chapter 11 Trustee or the appointment of a Chapter 11 Examiner to investigate any diversion of funds. The Court can also appointment a Chief Restructuring Officer to assume control over the Bankruptcy Debtor's books and records.

If the Trustee pursues a claim on behalf of the Bankruptcy Estate, any funds received are paid exclusively to the subcontractors who worked on the project. The funds received are not distributed to other creditors since the funds are not property of Bankruptcy Estate.

Finally, the Bankruptcy Court will monitor the bankruptcy proceeding. The Bankrupt Debtor cannot prolong the proceedings and avoid filing a reorganization plan. In the event there is a diversion of trust funds, the individual officers, directors and individuals controlling the trust funds could be held personally liable for the diversion.

Never let your lien time run out!

For a free copy of a pamphlet pertaining to mechanic's liens and payment bond claims, kindly contract.

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