CONSTRUCTION

November 19, 2025

Trust Us: Not All Construction Loan Funds are Subject to New York State's Lien Law Protection

By Mark D. Silverschotz & Caroline Levine

It is common for major construction projects undertaken as part of commercial or governmental developments to be funded by publicly sold bonds that form the foundation of complex financial transactions. Contractors and subcontractors working on such projects in New York typically will rely upon the relevant provisions of the New York Lien Law, which generally provides that the proceeds of construction loans are to be treated as a "trust fund" for their benefit. That said, this law does not necessarily apply to every dollar of every such loan, and anyone relying on the availability of those proceeds ought to be aware of certain limitations.

This article will address the basic requirements by which loan proceeds become subject to the Lien Law's trust provisions and identify certain pitfalls, particularly those relating to bond proceeds held by an indenture trustee prior to being formally lent. To be precise, although the money raised through the sale of bonds will produce the funds intended for use in a construction project, until such time as those funds actually are delivered to (that is, loaned out to) the borrowing entity (whether a developer or contractor), they generally will not become subject to the lien law trust.

New York Lien Law

Article 3-A of New York Lien Law, i [1]which contains the relevant trust fund provisions, protects contractors and subcontractors involved in construction projects by creating a trust for their benefit. New York Lien Law §§ 70–79a; see also 1 ALVIN L. ARNOLD & MYRON KOVE, CONSTRUCTION & DEVELOPMENT FINANCING § 4:307 (3d ed. 2025). Trust assets often come from loan proceeds, in particular "construction payments or funds," and ensure the "payment of subcontractors, suppliers, architects, engineers, laborers, as well as specified taxes and expenses of construction." Caristo Constr. Corp. v. Diners Fin. Corp., 236 N.E.2d 461, 463 (N.Y. 1968); see also Interworks Sys. Inc. v. Merch. Fin. Corp., 604 F.3d 692, 695 (2d Cir. 2010); Aquilino v. United States, 176 N.E.2d 826, 832 (N.Y. 1961); In re Grosso, 9 B.R. 815, 822 (Bankr. N.D.N.Y. 1981).

When a construction trust is created by operation of New York Lien Law § 70, owners and contractors are prohibited from using any of the assets for any reason other than satisfying the claims of the trust's beneficiaries until all such claims are satisfied. Interworks, 604 F.3d at 695; Canron Corp. v. City of New York, 631 N.Y.S.2d 642, 646 (App. Div. 1st Dep't 1995); LeChase Data/Telecom Servs., LLC v. Goebert, 844 N.E.2d 771, 776 (N.Y. 2006). Trust beneficiaries are generally "those in direct contractual privity with the trustee" and include those entities previously noted. Tutor Perini Bldg. Corp. v. N.Y. City Reg'l Ctr., LLC, 525 F. Supp. 3d 482, 505 (S.D.N.Y. 2021); Interworks, 604 F.3d at 695. However, not all proceeds are necessarily subject to the trust. Certain requirements must be met for the funds to qualify as trust assets.

Requirements for Proceeds to be Considered Trust Assets[2]

New York Lien Law § 70(1) (McKinney's) explains that for assets to be considered part of a trust, the funds must be "received by an owner for or in connection with an improvement of a real property," or by contractor or subcontractor "under or in connection with a contract [or a subcontract] for an improvement of real property, or home improvement, or . . . for a public improvement." Of note is the word "received," which means that the assets must have been "paid to the contractor or received by the owner in connection with an improvement of real property." Interworks, 604 F.3d at 695; see Interel Env't Techs., Inc. v. United Jersey Bank, 894 F. Supp. 623, 634 (E.D.N.Y. 1995). Without such receipt, no trust exists. Interel, 894 F. Supp. at 634; Seaboard Sur. Co. v. Mass. Bonding & Ins. Co., 232 N.Y.S.2d 809, 810 (App. Div. 1st Dep't 1962) ("The contractor, on the other hand, has not yet received the money in suit. When it does it will be . . . a trustee pursuant to the provisions of section 70."); In re Grosso, 9 B.R. at 824 ("Once the Debtor received any proceeds as owner, he became a statutory trustee to the extent of the funds received.").

Moreover, courts have strictly construed the language of § 70(1) and limited the receipt of funds to owners, contractors, and subcontractors for a trust to be created in this context. See, e.g., Tutor Perini, 525 F. Supp. 3d at 504; Utica Sheet Metal Corp. v. J. E. Schecter Corp., 262 N.Y.S.2d 583, 587 (Sup. Ct. 1965) ("No one other than an owner, contractor or subcontractor is designated as a prospective trustee in Article 3–A."); ALB Contracting Co. v. York-Jersey Mortg. Co., 401 N.Y.S.2d 934, 934–35 (App. Div. 4th Dep't 1978); In re Elm Ridge Assocs., 234 F.3d 114, 124–25 (2d Cir. 2000); Givoh Assocs. v. Am. Druggists Ins. Co., 562 F. Supp. 1346, 1350–51 (E.D.N.Y. 1983); In re Grosso, 9 B.R. at 824.

"Public improvement" and "improvement of real property" also have their own limiting definitions. A public improvement is defined as "an improvement of any real property belonging to the state or a public corporation," while an improvement of real property pertains to "any improvement of real property not belonging to the state or a public corporation." N.Y. Lien Law § 2(7)–(8) (McKinney). Notably, if an owner holds funds for a public improvement, those assets do not qualify for trust status. Tutor Perini, 525 F. Supp. 3d at 505; Tri-City Elec. Co. v. People, 468 N.Y.S.2d 283, 288 (App. Div. 4th Dept. 1983), aff'd, 473 N.E.2d 240 (1984); Canron, 531 N.Y.S.2d at 647; Givoh, 562 F. Supp. at 1351. If the funds are not received by (1) an owner for the improvement of real property or (2) a contractor or subcontractor for either a public improvement or improvement of real property, those assets are not considered trust funds. Fehlhaber Corp. v. Levitt, 315 N.Y.S.2d 169, 171 (Sup. Ct. 1969); Tri-City, 468 N.Y.S.2d at 288.

Cases Limiting Application of the Lien Law

Two cases in the federal courts illustrate the distinction between funds raised through a bond offering and those subsequently loaned to a borrower. These case exemplify the danger of presuming that bond proceeds yet to be loaned out (or "delivered") to a developer or contractor, although targeted for a construction project, will automatically and immediately be protected as trust funds. In Interel Environmental Technologies, Inc. v. United Jersey Bank, 894 F. Supp. 623 (E.D.N.Y. 1995), bond proceeds from an industrial development bond-funded project were excluded from trust fund status. Additionally, the court's decision in a lawsuit brought more recently in the bankruptcy of the National Sports Museum produced a similar result. In re Nat'l Sports Attraction, LLC, Adv. Proc. No. 09-01438 (RDD) (Bankr. S.D.N.Y. Feb. 19, 2010) (No. 42).

(i) Interel Environmental Technologies, Inc. v. United Jersey Bank

In Interel, Glen Cove, New York ("the City") solicited bids for an operator to run the City's Co–Disposal/Energy

Recovery Facility (the "Facility") and bring the Facility into conformity with environmental regulations. Interel, 894 F. Supp. at 626. The City selected defendant Island Recycling and Environmental Corporation ("Island"). Id. Per its agreement with the City, Island promised "to 'operate, maintain and manage' the Facility" and rebuild the Facility to satisfy environmental requirements "at its sole cost and expense." Id. To secure funding, Island borrowed money from defendant Glen Cove Industrial Development Agency (the "Agency"), which obtained funds through the issuance of special obligation revenue bonds, all or most of which were bought by defendant Allstate Insurance Company ("Allstate"). Id. Island and the Agency entered into a lease agreement, which designated that the Agency would hold title for all Facility improvements and lease them to Island. Id. In addition, the Agency and defendant United Jersey Bank (the "Bank") established a trust indenture, which created a $12 million fund to pay for the construction improvements. Id. Any subcontractor who wanted reimbursement would submit requests to Island, and if Island and the City approved such requests, the Bank, as indenture trustee, would remit to Island, which would then pay the subcontractor. Id. One such subcontractor was plaintiff Interel Environmental Technologies, Inc. ("Interel"), which was hired "to install certain air pollution control and related equipment." Id. at 627.

As a result of a dispute between the City and Island, the City stopped authorizing payments to Island and its subcontractors, prompting Interel to file a notice of lien and begin an Article 78 proceeding to force the City to release the funding it was owed. Id. While the proceeding was pending, Interel initiated a lawsuit in federal court "on behalf of itself and . . . other subcontractors" to obtain the fund assets. Id. at 625, 627. Interel asserted multiple causes of action, including a New York Lien Law claim. Id. at 628. Pursuant to the Lease Agreement, the Bank could not disburse $4.5 million of the $12 million fund without Island's confirmation that it complied with environmental regulations, but Allstate could redeem bonds for up to $4.5 million if compliance was not met by a particular date. Id. Because that date was approaching, Island had not yet complied with the regulations, and Interel's knowledge that Allstate intended to redeem the bonds, Interel moved for a preliminary injunction to stop the Bank and the other defendants from taking any money from the fund. Id. at 628–29. Interel argued that the fund was part of Island's trust and if Allstate withdrew any money from that fund, it would be a diversion of trust assets. Id. at 629.

The District Court for the Eastern District of New York analyzed Interel's likelihood to succeed on the merits. Id. at 631. The court held that Interel was unlikely to succeed because the funding that it asserted was a trust asset pursuant to New York Lien Law § 70(1) was not actually a trust. Id. at 632. The court first addressed Interel's argument that a lien can be asserted because the fund, which Interel said was a trust asset, "relate[d] to an 'improvement of real property.'" Id. at 633. The court found the real property plus the Facility on that realty to be owned by the Agency, which is a municipality, and thus the reconstruction of the Facility was a public improvement. Id. A lien, accordingly, could not be imposed on that basis. Id.

More significantly, the court also addressed Interel's second contention that the fund can be considered a trust asset because it contained money "received" by a contractor pursuant to a contract for a public improvement. Id. Although the court agreed that Island was a contractor and the bond proceeds were used to fund a public improvement, the court concluded that the money was not "received" by Island. Id. at 633–34. The court found that "the bond proceeds were put in a trust account for the benefit of the bondholder[s]," despite their declared "purpose of paying construction costs." Id. at 634 (emphasis in original). Indeed, Island "d[id] not own or control the proceeds in the [f]und." Id. The court held that without receipt, Interel was not likely to succeed on the merits. Id. After concluding that Interel "failed to establish irreparable harm," the court denied Interel's motion for preliminary injunction. Id. at 635.

(ii) In re National Sports Attraction, LLC

More recently, and similarly, in National Sports, defendants New York Liberty Development Corporation ("Liberty") and National Sports Attraction, LLC ("National Sports") entered into a loan agreement in which Liberty agreed to provide National Sports with a loan to fund the construction of the National Sports Museum. Memorandum of Law of Bank of New York Mellon in Support of Motion for Dismissal of Complaint & Other Relief at 2–3, In re Nat'l Sports Attraction, LLC, Adv. Proc. No. 09-01438 (RDD) (Bankr. S.D.N.Y. Oct. 23, 2009) (No. 12). Liberty sold bonds to obtain this funding and signed an indenture with defendant Bank of New York Mellon ("BNY Mellon"). Id. at 3. As the indenture trustee and assignee of Liberty's interests, BNY Mellon was designated a holder of a security interest in National Sports' assets. Id. The indenture and loan agreement prescribed the "flow of the funds" so that the bond proceeds would start with the bondholders, then go to Liberty, and end with BNY Mellon, which would deposit the bond sale proceeds into restricted accounts to be held "for the benefit of the owners of the [b]onds." Id. Consequently, BNY Mellon argued that the bond "[p]roceeds were not received directly by National Sports as borrower." Id. at 4. BNY Mellon disbursed funds pursuant to requisitions from National Sports to pay "[the] contractors, subcontractors, materialmen, suppliers, and others for the performance of work and the furnishing of materials and equipment for the construction of the physical plant and exhibits of the [National] Sports Museum." Id. at 5. National Sports and plaintiff Structure-Tone, Inc. entered into a construction management agreement. Id. at 7. Pursuant to this agreement, "Structure-Tone undertook to furnish labor, material, and equipment to the construction project." Id. When National Sports went into default, the bondholders instructed BNY Mellon "to distribute to them all of the funds representing the remaining proceeds of the bonds and all other monies in its possession in excess of $500,000," and BNY complied. Id. at 7-8. Following National Sports' declaration of Chapter 7 bankruptcy, Structure-Tone and other unnamed plaintiffs (collectively "Structure-Tone") brought an action against the defendants alleging "the[ir] receipt and/or participation in the diversion of the funds alleged to be trust assets" in violation of New York Lien Law, among other claims. Id. at 1, 9. Structure-Tone asserted that BNY Mellon, Liberty, and an additional defendant, the Depository Trust & Clearing Corporation/ Cede & Company ("DTC/Cede"), were considered trustees pursuant to New York Lien Law. Transcript of Motions to Dismiss Adversary Proceeding at 75, In re Nat'l Sports Attraction, LLC, No. 09-01438 (RDD) (Bankr. S.D.N.Y. Feb. 19, 2010) (No. 43). Those three defendants moved to dismiss. Id. at 69.

Following oral argument, the bankruptcy judge delivered his opinion, holding that the case should be dismissed as to BNY Mellon, Liberty, and DTC/Cede on all claims. Id. at 69, 82. Pertaining to the Lien Law claim, the court held that BNY Mellon, Liberty, and DTC/Cede were not owners, contractors, or subcontractors, which the statute states are the "only . . . types of entities" that can be held liable. Id. at 76–77. The court was not persuaded by Structure-Tone's argument that Liberty and BNY Mellons' status as mortgagees garnered them trustee status, since New York case law specifies "that mortgagee[s] status does not equate with being a statutory trustee under the Lien Law" and this status did not render either defendant an owner. Id. at 77–78. Furthermore, the court found that there had been no assertion that there was direct receipt of funds in this matter, which it deemed "necessary . . . to survive a motion to dismiss." Id. at 81.

Conclusion

What is clear from the foregoing is that contractors and subcontractors need to look beyond the mere title of a loan and focus on the "mechanics." Is the project bond-funded, equity-funded, or bank-funded? Where do the proceeds sit? Are they subject to a security interest? Have the loan proceeds been "received" by the developer (or general contractor)?

Trust Us: Not All Construction Loan Funds are Subject to New York State's... Cont'd

The good news is that contractors and subcontractors can be trust beneficiaries. However, it cannot be assumed that all the funds are part of the trust. Pay attention to the flow of the funds, particularly whether they have been "received", as well as the source of the assets and the type of improvement, to ensure trust funds are safeguarded for their intended beneficiaries.

Authors

Caroline Levine / *clevine@andersonkill.com*
Caroline is a Law Clerk at Anderson Kill.

Mark D. Silverschotz / *msilverschotz@andersonkill.com*
Mark co-chair of Anderson Kill's Bankruptcy & Restructuring Practice Group, has worked in the bankruptcy and reorganization field since 1981, representing secured, unsecured, and subordinated creditors.

Endnotes

1Article 3-A is titled "Definition and Enforcement of Trusts."
2 New York Lien Law § 70(5) (McKinney) lists sources where funds must originate to be considered Article 3-A trust assets. If the funds do not come from one of those specific sources, § 70 is not applicable. See Bristol, Litynski, Wojcik, P.C. v. Elliott, 436 N.Y.S.2d 190, 191 (Sup. Ct. 1981); Pellic Dev. Corp. v. Whitestone Equities Farmingdale Corp., 570 N.Y.S.2d 442, 443–44 (Sup. Ct. 1991); Lurgi, Inc. v. Ne. Biofuels, LP, No. 5:09–MC–0024 (GTS/GHL), 2009 WL 910042, at *5 n.3 (N.D.N.Y. Apr. 2, 2009).

Known as the Policyholder Powerhouse™, Anderson Kill is a pioneer in insurance coverage litigation: we have more experience in litigating, trying and settling insurance coverage disputes than any other law firm. As the only four-time winner of Business Insurance's **Legal Team of the Year** (including 2024), our firm has an extraordinary record of obtaining insurance coverage for policyholders in connection with all manner of insured losses. The firm has offices in New York, NY; Boston, MA; Denver, CO; Los Angeles, CA; Newark, NJ; Philadelphia, PA; Stamford, CT; and Washington, D.C.