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## Creditors' Rights—Contractor Has No Property Right in Trust Funds Held for Subcontractor

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process of law. He argued that the contract allegedly impaired, and the property rights in question, derived from the old State Housing Law.

The Court of Appeals held that by the express terms of the statute any such contract and rights acquired were qualified ones. The purpose of the statute was to eradicate congested and unsanitary housing conditions prevailing in low priced dwellings by permitting construction of new facilities, in accord with proper standards of sanitation and safety, at a cost which would permit rentals which wage earners could afford.<sup>48</sup> In return for the privilege of incorporating under this statute and receiving its benefits such as tax exemptions, defendant agreed in its certificate of incorporation that all property acquired by it would be subject to the provisions of the State Housing Law.<sup>49</sup> This law, incorporated by reference into the corporation's charter, was always subject to future change required to promote effectively the objectives of the statute. The subsequent amendments to the statute, being a reasonable application of the police power, and being related to the objects of the legislation, were not unconstitutional.

The Court further considered the effective date of the rental surcharge. At the commencement of the action, the surcharge was based upon a regulation by the Commissioner of Housing.<sup>50</sup> While plaintiff's appeal was pending in the Appellate Division, the Legislature amended the statute to specifically provide for such surcharges.<sup>51</sup> The Court found that prior to the date of the amendment, the Legislature had not intended to impose a surcharge on private housing co-operatives. Thus, the Commissioner's regulation conflicted with his statutory authority and was invalid. There being no indication that the amendment was intended to impose surcharges *nunc pro tunc*, its application was prospective only.

*Bd.*

## CREDITORS' RIGHTS

### CONTRACTOR HAS NO PROPERTY RIGHT IN TRUST FUNDS HELD FOR SUB-CONTRACTOR

In *Aquilino v. United States*,<sup>1</sup> Aquilino and his co-partner, doing business under the name of Home Maintenance Co., together with Colonial Sand and Stone Co. entered into contracts with Fleetwood Paving Corporation, the general contractor, to furnish labor and material for remodeling a restaurant owned by Ada Bottone. On October 31, 1952, Federal tax liens were filed against Fleet-

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48. N.Y. State Housing Law § 2.

49. N.Y. State Housing § 30(12).

50. Reg. 12, Commissioner of Housing.

51. *Supra* note 47.

1. 10 N.Y.2d 271, 219 N.Y.S.2d 254 (1961).

wood.<sup>2</sup> Some days later the subcontractors, their work completed, filed notice of mechanics' liens against the owner's realty. The owner deposited in court the sum she still owed Fleetwood to be distributed according to the decision of the court.

In an action by the subcontractors to foreclose the mechanics' lien, Special Term granted plaintiff's motion for summary judgment on the ground that the Government's lien was defective because it had not been filed in the county clerk's office; the place designated by statute for filing liens against property.<sup>3</sup> The Appellate Division affirmed but on different grounds.<sup>4</sup> In the approach taken by the Appellate Division, the fund deposited in court by the owner was a substitute for real property and since the United States had no lien against the property, it could not have a lien against its substitute.

The Court of Appeals reversed, holding that the Government's lien was asserted against the debt owed by Bottone to Fleetwood and as such was properly filed under the statutes controlling liens against personal property.<sup>5</sup> Since the Government's lien was filed first, it could not be defeated by a subsequently filed mechanics' lien.

The United States Supreme Court granted certiorari,<sup>6</sup> vacated the judgment and remanded the case to the Court of Appeals stating that the primary question was whether the taxpayer had "property" or "rights to property": "In answering that question, both federal and state courts must look to state law, . . ."<sup>7</sup>

On remand, the Court of Appeals affirmed the judgment of the Appellate Division, concluding after an extensive discussion that "a contractor does not have a sufficient interest in moneys, due or to become due from the owner under the contract, to give him a property right in it, except in so far as there is a balance remaining after all subcontractors and other statutory beneficiaries have been paid."<sup>8</sup>

The Court of Appeals, in construing former Section 36-a of the Lien Law,<sup>9</sup> pointed out that it was designed to curb the practice in the construction business of owners and contractors using money advanced for one project to finance unrelated projects to the detriment of subcontractors and materialmen. To prevent this evil, Section 36-a declared that funds received by a contractor from the owner constituted trust funds for the benefit of enumerated beneficiaries. However, at first there was no civil remedy for enforcing this trust, but merely criminal sanctions.<sup>10</sup> In 1942, the Legislature amended Section 36-a

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2. Int. Rev. Code of 1954 § 6321.

3. Aquilino v. United States, 140 N.Y.S.2d 355 (Sup. Ct. 1955).

4. Aquilino v. United States, 2 A.D.2d 747, 153 N.Y.S.2d 268 (2d Dep't 1956).

5. Aquilino v. United States, 3 N.Y.2d 511, 169 N.Y.S.2d 9 (1957).

6. Aquilino v. United States, 363 U.S. 509 (1960).

7. Id. at 512.

8. Supra note 1 at 278, 219 N.Y.S.2d at 262.

9. Section 36(a) of the Lien Law was repealed in 1959. Its provisions, with modifications, were transferred to a new Article 3-A, Lien Law §§ 70-79. For detailed discussion, see Meyer, "Trust Fund Provision of Mechanics Lien Law," 10 Buffalo L. Rev. 314.

10. Section 36(a) as enacted L. 1930, ch. 859, § 18, effec. Oct. 1, 1930.

to provide that the trust created by it could be enforced by a civil action.<sup>11</sup> However, subsequent decisions of the courts had stated that the trust thus created was not a trust in the ordinary sense, where the trustee holds only bare legal title for the benefit of the cestui.<sup>12</sup>

The Court of Appeals stated that although it once may have been possible for the contractor to divert funds from the trust to his own purposes, since the amendment of 1942, trust funds must be used for trust purposes. That is, they are to be paid first to the statutory beneficiaries to the amount of their claims and any amount still remaining will then, and only then inure to the benefit of the trustee. This is so even though the contractor is not required to hold the fund intact until the work is completed, and he may also assign his rights, commingle his funds and trust funds. The remedy against him is a class action. By contrast, the normal trustee is required to hold the fund intact, separate from other funds and this may be enforced by an individual cestui. These differences from the ordinary trustee-cestui relationship are an inherent necessity of the type of trust created and even though it is true that they weaken the cestui's position, they do not correspondingly increase the interests of the trustee.

It should be noted that Section 36-a of the Lien Law was repealed and its provisions, with modifications, incorporated in Sections 70-79, Article 3-A of the Lien Law.<sup>13</sup> "Their purpose is to integrate, clarify, and strengthen the provisions of the Lien Law declaring that certain funds are trust funds for payment of claims arising in an improvement of real property or arising in the performance of a contract or subcontract for an improvement of real property or a public improvement."<sup>14</sup>

In the case of *American Blower Corporation v. James Talcott, Inc.*,<sup>15</sup> the Court of Appeals applied the foregoing trust theory to competing claims of an assignee under a construction contract and a sub-subcontractor. The Court held that, although the statutory trustee is empowered to make assignments of payments due to him, it is necessary for the assignee to record the assignment as required by the statute or the subcontractor will prevail.

D. G. M.

STATUTORY PROTECTION OF CONDITIONAL VENDEE OF GOODS FOR RESALE

In *Rand's Discount Co. v. Universal C.I.T. Credit Corp.*,<sup>16</sup> the Court of Appeals withdrew from the field of speculation an interesting argument in the

11. L. 1942, ch. 808, § 4: Such trust must be enforced by Civil action . . . by any person entitled to share in the fund, whether or not he shall have filed or had the right to file, a notice of lien. . . .

12. *Gramatan-Sullivan v. Koslow*, 240 F.2d 533 (2d Cir. 1957); *United States v. Kings County Iron Works, Inc.*, 224 F.2d 232 (2d Cir. 1955).

13. *Supra* note 9.

14. 1959 Report, Recommendation and Studies, N.Y. Law Rev. Comm. pp. —. Quoted in *Lien Law* (McKinney's 1961 Supp. 99).

15. 10 N.Y.2d 282, 219 N.Y.S.2d 263 (1961).

16. 9 N.Y.2d 454, 214 N.Y.S.2d 721 (1961).