

H&L Ironworks Corp. v McGovern & Co., LLC
2018 NY Slip Op 31772(U)
July 25, 2018
Supreme Court, New York County
Docket Number: 153853/2016
Judge: Carol R. Edmead
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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H&L IRONWORKS CORP., on behalf of itself and on behalf
of all persons entitled to share in the funds received by
McGovern & Company LLC in connection with a project
identified as 10 East 53rd Street, New York, New York,

DECISION/ORDER

Index no. 153853/2016

Plaintiff,

Mot Seq. 008

-against-

MCGOVERN & COMPANY, LLC, 10E53 OWNER LLC,
ATLANTIC SPECIALTY INSURANCE COMPANY,
DANIEL G. MCGOVERN, and "JOHN DOE NO. 1"
through "JOHN DOE NO. 10", defendants being fictitious
and unknown to plaintiff but intended to be parties liable for
the diversion of trust funds pursuant to Article 3-A of the
Lien Law,

Defendants.

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HON. CAROL R. EDMEAD, J.S.C.:

MEMORANDUM DECISION

This is a lien foreclosure action. Plaintiff H&L Ironworks Corp. ("Plaintiff") on behalf of itself and on behalf of all persons entitled to share in the funds received by McGovern & Company LLC in connection with a project identified as 10 East 53rd Street, New York, New York ("Class Plaintiffs"), now moves for an order pursuant to CPLR 3212 granting Plaintiff and all persons entitled to share in the funds received by defendants McGovern & Company LLC ("McGovern & Co.") and Daniel G. McGovern ("McGovern") (collectively "Defendants") in connection with a construction project, partial summary judgment on the sixth through thirteenth causes of action contained in its second amended complaint ("Complaint"), interim relief pursuant to Lien Law § 77(3)(a)(i), (iv), and (v), and to sever its sixth through thirteenth causes of action and ordering an evidentiary hearing to determine the amount of trust funds to be recovered by Class Plaintiffs, including attorneys' fees.

Factual Background

According to the Complaint, defendant 10E53 Owner LLC ("10E53") is the owner of a building and construction project (the "Project"). The Complaint further claims that McGovern & Co. was hired by 10E53 as a general contractor for the Project and that Plaintiff was hired by defendant McGovern & Co. to perform work at the Project. Defendant Daniel G. McGovern is the president of McGovern & Co. Plaintiff alleges that defendant McGovern & Co. received funds in connection with the Project for labor constituting trust assets under Lien Law article 3-A. Plaintiff further alleges that it furnished labor and materials under the Project, but that it was not paid. Additionally, Plaintiff alleges that Defendants diverted trust assets from the trusts in violation of Lien Law article 3-A.

Plaintiff's sixth through ninth causes of action seek to enforce the Article 3-A trusts pursuant to Lien Law § 77. Plaintiff's tenth through thirteenth causes of action seek to hold individual defendant McGovern and "Jane Doe No. 1" through "Jane Doe No. 10" personally liable for the alleged diversion of trust assets and punitive damages pursuant to Lien Law § 79.

Plaintiff's Motion

Plaintiff argues that it is entitled to summary judgment of its sixth through thirteenth causes of action because Defendants diverted trust assets. Plaintiff contends that four separate trust funds were created, wherein Defendants were trustees under Article 3-A. Specifically, Plaintiff contends that McGovern & Co., as the contractor performing services at the Project, received approximately \$17,590,802.43 from 10E53 to perform work on the Project. Plaintiff further contends that it has demonstrated a statutory presumption that Defendants diverted the trust assets, since Defendants failed to furnish Plaintiff a sufficient verified statement pursuant to Lien Law § 76. Plaintiff also contends that it has demonstrated the actual improper diversion of

trust assets. Specifically, Plaintiff contends that Defendants' bank account records demonstrates that Defendants paid approximately \$11,519,784 of trust funds for purposes other than the Article 3-A trusts. Next, Plaintiff argues that McGovern should be held individually liable for the diversions of the Project trust funds. Plaintiff further argues that it is entitled to interim relief pursuant to Lien law §77(3)(a)(i), (iv), and (v). Finally, Class Plaintiffs argue that the six through thirteenth causes of action should be severed and a trial on damages should be held to determine the amount of project trust funds to which the Plaintiff and Class Plaintiffs are entitled.

Defendants' Opposition

In opposition to Plaintiff's motion, Defendants argue that there is no presumption of diversion, since it furnished Plaintiff with a verified statement and supplemental verified statement. Next, Defendants argue that the evidence on the record does not support actual trust diversions. Specifically, Defendants contend that the payments made from its bank account included payments to contractors that performed work on the Project and that proceeds from the nine contracts entered into between 10E53 and Defendants were being deposited into Defendants' bank account.

Next, Defendants argue that Plaintiff failed to demonstrate that Defendants are obligated to pay Plaintiff for the work it allegedly performed. Defendant further contends that there is an issue of fact as to whether Plaintiff is entitled to relief on its breach of contract claims, specifically, whether Plaintiff completed the jobs it was contracted to perform. Further, Defendants argue that relief under Lien Law § 77(3)(a) is inappropriate, since the owner is in possession of the retainage. Moreover, Defendants argue that it is no longer receiving funds from 10E53 related to the Project. Finally, Defendants argue that Plaintiff's motion is premature since discovery is incomplete, as Plaintiff has not responded to discovery demands.

Discussion

“[T]he proponent of a summary judgment motion must make a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact. Failure to make such *prima facie* showing requires denial of the motion, regardless of the sufficiency of the opposing papers” (*Alvarez v Prospect Hosp*, 68 NY2d 320, 324 [1986] [internal citations omitted]). Once *prima facie* entitlement has been established, in order to defeat the motion, the opposing party must “ ‘assemble, lay bare, and reveal his [or her] proofs in order to show his [or her] defenses are real and capable of being established on trial... and it is insufficient to merely set forth averments of factual or legal conclusions’ ” (*Genger v Genger*, 123 AD3d 445, 447 [1st Dept 2014], quoting *Schiraldi v U.S. Min. Prods.*, 194 AD2d 482, 483 [1st Dept 1993]). If there is any doubt as to the existence of a triable fact, the motion for summary judgment must be denied (*Rotuba Extruders v Ceppos*, 46 NY2d 223, 231 [1978]).

Lien Law

“Article 3-A of the Lien Law creates ‘trust funds out of certain construction payments or funds to assure payment of subcontractors, suppliers, architects, engineers, laborers, as well as specified taxes and expenses of construction’ ” (*Aspro Mech. Contr., Inc. v. Fleet Bank, NA*, 1 N.Y.3d 324, 328 [2004], quoting *Caristo Constr. Corp. v. Diners Fin. Corp.*, 21 N.Y.2d 507, 512 [1968], citing Lien Law §§ 70, 71). “[T]he primary purpose of the Lien Law is to ensure that ‘those who have directly expended labor and materials to improve real property . . . at the direction of the owner or a general contractor’ receive payment for the work actually performed” (*Canron Corp. v. City of New York*, 89 N.Y.2d 147, 155, [1996]). “To ensure this end, the Lien Law establishes that designated funds received by owners, contractors and subcontractors in

connection with improvements of real property are trust assets and that a trust begins ‘when any asset thereof comes into existence, whether or not there shall be at that time any beneficiary of the trust’ ” (*Aspro Mech. Contr., Inc.*, 1 N.Y.3d at 328, quoting Lien Law § 70[1], [3]; *see also City of New York v. Cross Bay Contr. Corp.*, 93 N.Y.2d 14, 19 [1999]). Lien Law § 70(2) provides that:

“[t]he funds received by a contractor or subcontractor and the rights of action with respect thereto, under or in connection with each contract or subcontract, shall be a separate trust and the contractor or subcontractor shall be the trustee thereof.”

Additionally, corporate officers may thus be held “liable for trust funds otherwise diverted by their corporation provided that the corporate officer charged knowingly participated in the diversion by the corporation” (*Edgewater Constr. Co., Inc. v 81 & 3 of Watertown*, 1 AD3d 1054 [4th Dept 2003]; *see Fleck v. Perla*, 40 A.D.2d 1069 [4th Dept 1972]).

Initially, the Court finds that there were nine contracts between 10E53 and defendant McGovern & Co. under which McGovern & Co. received funds from 10E53 for the improvement of real property (i.e. construction at the Project). Significantly, four of those contracts, dated April 2, 2014; July 7, 2014; September 10, 2014; and November 7, 2014 (“Project Agreements”), involved steelwork where McGovern & Co. hired Plaintiff as a subcontractor. As a result, each contract between 10E53 and defendant McGovern & Co. (i.e., Project Agreements) established a separate trust (Lien Law § 70[1], [2]). Moreover, Defendants’ own Notice to Admit indicates that McGovern & Co. received thirty-three separate checks from 10E53 in connection with the Project totaling approximately \$17,590,802.43 and the affidavit of Robert DeWitt indicates that 10E53 paid the same amount to McGovern & Co. pursuant to the four Project Agreements. Thus, McGovern & Co. is a trustee for the purpose of Lien Law Article 3-A.

The Court further finds that the trust assets were improperly diverted. “An improper diversion of the contractor's trust assets occurs when any such trust asset is paid, transferred or applied for a non-trust purpose, that is, for any purpose other than the expenditures authorized in section 71(2), before all of the trust claims have been paid or discharged” whether or not the trust claims are in existence at the time of the transaction (*Canron Corp. v. City of New York*, 89 N.Y.2d 147, 154 [1996]; Lien Law § 72 [1]).

There is no dispute that Plaintiff is a beneficiary to the trust assets. Further, Plaintiff has shown, and Defendants do not dispute, that the Project funds paid by 10E53 to McGovern & Co. pursuant to the Project Agreements were all deposited into McGovern & Co.'s Merrill Lynch bank account. McGovern & Co. further does not dispute that over \$11,519,604.50 of trust assets were paid from the Merrill Lynch account to various non-trust beneficiaries. Plaintiff submits the Merrill Lynch bank records which demonstrates that McGovern & Co. paid over \$8,419,576.79 to various contractors who are not beneficiaries to the trust funds created by the Project Agreements.¹ Plaintiff further demonstrate that McGovern & Co. paid \$1,535,052.12 to labor union fringe benefit funds not related to the Project. Defendants argue that some of the disbursements from the trusts were payments to some of the contractors that worked on the Project. However, Defendants fail to provide evidence that those contractors worked on one of the projects pursuant to the Project Agreements, thus, failing to demonstrate that the diversions to those contractors were permitted. In any event, the evidence demonstrates that McGovern & Co. transferred trust funds to other non-trust purposes. Specifically, the bank records show that McGovern & Co. transferred \$1,176,236.91 to McGovern's wife, \$296,320.13 to McGovern's brother, and \$92,418.53 to his attorney. Defendants fail to address those transfers in their

¹ The Court notes that neither the Verified Statement nor Supplemental Verified Statement identifies the non-Project contractors identified as having received transfers.

opposition. As of August 31, 2016, the remaining balance in the Merrill Lynch bank account was \$187.09. Accordingly, the Court finds that Plaintiff is entitled to summary judgment on its sixth through ninth causes of action.

Moreover, Defendants' argument that Plaintiff is not entitled to relief under its sixth through ninth causes of action because it has not established its entitlement to payment for the work it allegedly performed is unsupported by any caselaw. Defendants' citation to *Skycom SRL v. FA & Partners, Inc.*, 2016 Slip Op. 31621(U) (Sup. Ct. N.Y. County 2016) is misplaced. In *Skycom*, plaintiffs sought payment for defendant's alleged improper diversions of Article 3-A trust funds. The court denied plaintiff's motion for summary judgment, finding an issue of fact as to whether plaintiff was entitled to payments pursuant to its agreements with defendant. Here, the sixth through tenth causes of action only seek non-monetary relief.

Defendants further argue that Plaintiff's motion for summary dismissal is premature since there is still discovery to take place. However, to defeat a motion for summary judgment due to incomplete discovery, there must be "some evidentiary basis ... offered to suggest that discovery may lead to relevant evidence" (*DaSilva v. Hah Engineers, Architects & Land Surveyors, P.C.*, 125 A.D.3d 480, 482 [1st Dept 2015]). While Defendants claim that Plaintiff failed to respond to Defendants' discovery demands, Defendant has indeed offered no facts from which it could be inferred that further discovery will produce relevant evidence. Defendants' hope that further discovery in this case will lead to relevant evidence is without basis.

Plaintiff's fail, however, to make a *prima facie* showing entitling it to relief of its tenth through thirteenth causes of action. Specifically, Plaintiff's request that McGovern and "Jane Doe No. 1" through "Jane Doe No. 10" be personally liable is, at this stage, denied, as there is an issue of fact as to whether the individual defendants knowingly diverted trust funds. (*see* Lien

Law § 79-a; *ARA Plumbing & Heating Corp. v. Abcon Assocs., Inc.*, 44 A.D.3d 598, 599 [2d Dept 2007]; *S.C. Steel Corp. v. Miller*, 170 A.D.2d 592, 595 [2d Dept 1991]; *Fleck*, 40 A.D.2d at 1070)). Other than Plaintiff's counsel's affirmation stating that McGovern is McGovern & Co.'s managing member and that he had financial control over McGovern & Co. with respect to the Project, there is no evidence that he knowingly diverted trust funds. Accordingly, the branch of Plaintiff's motion for summary judgment on its tenth through thirteenth causes of action is denied.

Further, Plaintiffs have demonstrated its entitlement to relief under Lien Law §77(3)(a)(i) and (v), requiring an interim or final accounting by the trustee and terminating or limiting the authority of the trustee in the application of trust assets or of any trust asset, or directing the time and manner of application of a trust asset or part thereof, respectively. However, Plaintiff is not entitled to relief under Lien Law § 77(3)(a)(v), requiring the trustee to give security to ensure the proper distribution of the trust assets, as an issue of fact exists as to the amount owed by Defendants (*see Brooklyn Navy Yard Dev. Corp. v. J.M Dennis Constr. Corp.*, 12 A.D.3d 630, 632 [2d Dept 2004]).

Finally, Plaintiff is entitled to the severance of the sixth through ninth causes of action and an evidentiary hearing, to determine, among other things, the amount of trust funds Plaintiff is entitled to recover, as the Court finds that doing so will expedite the disposition of this matter (*see Cross v Cross*, 112 AD2d 62 [1st Dept 1985] [severance of claims is subject to the sound discretion of the trial judge and may be used to facilitate the speedy disposition of cases]). The Court has discretion in ruling on motions to sever any claims, and order a separate trial of any claims or issues (CPLR 603; *Baseball Office of Com'r v. March & McLennan, Inc.*, 295 A.D. 73 [1st Dept 2002]).

CONCLUSION

Accordingly, it is hereby

ORDERED that the branch of the motion of plaintiff H&L Ironworks Corp. on behalf of itself and on behalf of all persons entitled to share in the funds received by McGovern & Company LLC in connection with a project identified as 10 East 53rd Street, New York, New York for partial summary judgment is granted, as to defendant McGovern & Co., to the extent that summary judgment is granted as to the sixth through ninth causes of action contained in the second amended complaint. It is further

ORDERED that the branch of Plaintiff's motion requiring Defendants to give adequate security is denied, without prejudice. It is further

ORDERED that the branch of Plaintiff's motion compelling Defendants to produce their entire trust fund records and directing an interim accounting by a forensic accountant of Plaintiff's choice and the Court's approval, at Defendants' expense, and granting Plaintiff leave to renew the instant motion subsequent thereto, is granted, as to defendant McGovern & Co. The aforementioned forensic accountant shall be appointed at the forthcoming status conference. It is further

ORDERED that the branch of Plaintiff's motion seeking to limit the authority of the Defendants to disburse trust assets to legitimate trust purposes, requiring prior notice and the Court's approval of any such disbursements and ordering that Defendants and/or their agents to cooperate fully in producing documentation and information in connection with the interim accounting ordered herein, is granted, as to defendant McGovern & Co. It is further

ORDERED that the branch of Plaintiff's motion seeking the severing the sixth through thirteenth causes of action in the amended complaint and ordering Plaintiff and Defendants to appear for an evidentiary hearing, within a reasonable period of time following the results of the interim forensic accounting sought herein, to determine the amount of trust funds to be recovered by Plaintiff and Class Plaintiffs together with interest thereon, along with a determination as to the amount of attorneys' fees, disbursements, and/or costs pursuant to CPLR § 909 to which Plaintiff is entitled as class representative, is granted, as to defendant McGovern & Co. The date for the hearing will be set at the conference on September 11, 2018. It is further

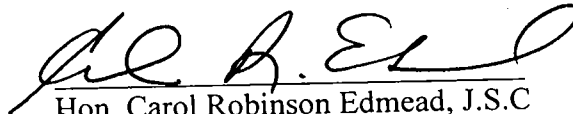
ORDERED that the sixth through thirteenth causes of action are severed, while the remainder of the case shall proceed against the remaining defendants. It is further

ORDERED that the parties shall appear for an in-court conference on September 11, 2018, at 10:00 a.m. it is further

ORDERED that counsel for Plaintiff shall serve a copy of this order with notice of entry upon all parties within ten (10) days of entry.

This constitutes the decision and order of the Court.

Dated: July 25, 2018


Hon. Carol Robinson Edmead, J.S.C.
HON. CAROL R. EDMead
J.S.C.