

Getting Paid: “Pay-When-Paid” and “Pay-If-Paid” or Something Else?

I. Introduction

Most subcontracts contain conditions which must be satisfied before the general contractor’s obligation to pay the subcontractor arises. Among other things, payment clauses often contain language conditioning the general contractor’s payment obligation upon its receipt of payment from the owner. Those clause are commonly referred to as “pay-when-paid” or “pay-if-paid” clauses.

Issues surrounding conditional payment clauses have recently become the focus of many court decisions. In most situations, courts have concluded that, unless the parties explicitly and unambiguously provide otherwise, a general contractor must pay a subcontractor within a “reasonable time” after the subcontractor completes its work, regardless of whether the owner has paid the general contractor for the work. Most importantly, unless explicitly provided, the general contractor typically bears the risk that the owner might become insolvent or that the owner may refuse to make payment. In light of that general rule, general contractors have attempted to implement subcontract language that will effectively shift the risk of nonpayment and owner insolvency to its subcontractors.

II. Typical Language

In attempting to shift the risk of owner non-payment, general contractors have employed various payment clauses. Examples of such clauses are set forth below:

A. Standard Form Subcontracts

1. AIA Document A401: Standard Form of Agreement Between Contractor and Subcontractor (1987 ed.)

a. Progress Payments

Article 11.3: The Contractor shall pay the Subcontractor each progress payment within three working days after the Contractor receives payment from the Owner. If the Architect does not issue a Certificate for Payment or the Contractor does not receive payment for any cause which is not the fault of the Subcontractor, the Contractor shall pay the Subcontractor, on demand, a progress payment computed as provided in Paragraphs 11.7 and 11.8.

b. Final Payment

Article 12.1: Final payment constituting the entire unpaid balance of the Subcontract Sum, shall be made by the Contractor to the Subcontractor when the Subcontractor’s Work is fully performed in accordance with the requirements of the Contract Documents, the Architect has issued a Certificate for Payment covering the Subcontractor’s completed Work and the Contractor has received payment from the Owner. If, for any cause which is not the fault of the Subcontractor, a Certificate for Payment is not issued or the Contractor does not receive timely payment or does not pay the Subcontractor within three working days after receipt of payment from the Owner, final payment to the Subcontractor shall be made upon demand.

2. AGC/ASA/ASC Standard Form Subcontract (1994)

a. Progress Payments

Article 14.2.7: Time of Payment- Progress payments to the Subcontractor for satisfactory performance of the Subcontract Work shall be made no later than seven (7) calendar days after receipt by the Contractor of payment from the Owner for the Subcontract Work. If payment from the Owner for such Subcontract Work is not received by the Contractor, through no fault of the Subcontractor, the Contractor will make payment to the Subcontractor within a reasonable time for the Subcontract Work satisfactorily performed.

Article 14.2.8: Payment Delay - If for any reason not the fault of the Subcontractor, the Subcontractor does not receive a progress payment from the Contractor within seven (7) calendar days after the time such payment is due, as defined in Subparagraph 14.2.7, or within fourteen (14) calendar days after the time payment is due from the Owner to the Contractor for such Subcontract Work as defined in the Contract, then the Subcontractor, upon giving seven (7) calendar days' written notice to the Contractor, and without prejudice to and in addition to any other legal remedies, may stop its Subcontract Work until payment of the full amount owing to the Subcontractor has been received. The Subcontract Price and Subcontract Time shall be increased by the amount of the Subcontractor's reasonable cost of shutdown, delay and start-up, which shall be effected by appropriate Subcontract Change Order.

b. Final Payment

Article 14.3.3: Time of Payment - Final payment of the balance due of the Subcontract Price shall be made to the Subcontractor within seven (7) calendar days after receipt by the Contractor of final payment from the Owner for such Subcontract Work.

Article 14.3.4: Final Payment Delay - If the Owner delays final payment for the Subcontract Work, or the Contractor does not receive final payment for the Subcontract Work for any cause which is not the fault of the Subcontractor, the Contractor shall promptly inform the Subcontractor in writing. The Contractor also shall diligently pursue, with the assistance of the Subcontractor, the prompt release by the Owner of the final payment due for the Subcontract Work.

If final payment from the Owner for such Subcontract Work is not received by the Contractor, through no fault of the Subcontractor, the Contractor will make payment to the Subcontractor within a reasonable time.

2. AGC Standard Form Subcontract (Short Form) (1987) - AGC Document No. 603

Contract Payment: Progress payments, less retainage of __%, shall be made to Subcontractor for Work satisfactorily performed no later than seven (7) days after receipt by Contractor of payment from Owner for Subcontractor's Work. Final payment of the balance due shall be made to Subcontractor no later than seven (7) days after receipt by Contractor of final payment from Owner for Subcontractor's Work. These payments are subject to receipt of such lien waivers, affidavits, warranties and guarantees required by the Contract Documents or Contractor.

B. Private Subcontracts

1. Company B

a. Progress Payment

Progress payments shall not become due unless and until Contractor receives payment for such Work from the Owner.

b. Final Payment

Final Payment shall not become due unless and until the following conditions precedent to Final Payment have been satisfied: (a) approval and acceptance of Subcontractor's Work by Owner, Architect and Contractor; (b) delivery to Contractor of all manuals, "as-built" drawings, guarantees, and warranties for material and equipment furnished by Subcontractor, or any other documents required by the Contract Documents; (c) receipt of Final Payment for Subcontractor's Work by Contractor from Owner; (d) furnishing to Contractor of satisfactory evidence by Subcontractor that all labor and material accounts incurred by Subcontractor in connection with his work have been paid in full; and (e) furnishing to Contractor a complete Affidavit, Release of Lien and Waiver of Claim by Subcontractor in the form attached hereto as Exhibit "D", and as required by the Contract Documents. (emphasis added).

2. Company C

a. Price

The sum to be paid by General Contractor, out of funds received from the Owner, to the Subcontractor for the satisfactory performance and completion of the Work and all of the duties, obligations and responsibilities of the Subcontractor under this Agreement and the other Contract Documents shall be \$

b. Progress Payments

On or before the last day of each month, the Subcontractor shall submit to General Contractor, in the form required by General Contractor, a written requisition for payment showing the proportionate value of the Work installed to that date, from which shall be deducted: a reserve of ten per cent (10%); all previous payments; and all charges for services, materials, equipment and other items furnished by General Contractor to or chargeable to the Subcontractor; and the balance of the amount of such requisition, as approved by General Contractor and the Architect and for which payment has been received by General Contractor from the Owner, shall be due and paid to the Subcontractor on or about the fifteenth (15th) day of the succeeding month.

The obligation of General Contractor to make a payment under this Agreement, whether a progress or final payment, or for extras or change orders or Delays to the Work, is subject to the express condition precedent of payment therefor by the Owner. If General Contractor has provided payment or performance bonds or a combination payment and performance bond, the obligation of General Contractor and its surety under any of those bonds to make any payment (whether a progress payment or final payment) to a claimant on that bond is similarly subject to the express condition precedent of payment therefor by the Owner. (emphasis added).

c. Final Payment

Final payment to the Subcontractor shall be made only with funds received by General Contractor from the Owner, the Construction Lender or the Owner's Agent as final payment for work under the General Contract. Final payment to General Contractor by the Owner shall be an express condition precedent which must occur before General Contractor shall be obligated to make final payment to the Subcontractor. In addition, final payment by General Contractor to the Subcontractor shall not become due and payable until the following other express condition precedent have been met (1) the completion and acceptance of the Work by General Contractor and the Architect; (2) provision by the Subcontractor of evidence satisfactory to General Contractor that there are no claims, obligations or liens outstanding or unsatisfied for labor, services, materials, equipment, taxes or other items performed, furnished, or incurred for or in connection with the Work; and (3) execution and delivery by the Subcontractor, in a form satisfactory to General Contractor, of a General Release running to and in favor of General Contractor and the Owner. Should there prove to be any such claim, obligation or lien after final payment is made, the Subcontractor shall refund to General Contractor all monies that General Contractor and/or the Owner

shall pay in satisfying, discharging or defending against any such claim, obligation or lien or any action brought or judgment recovered thereon and all costs and expenses, including legal fees and disbursements, incurred in connection therewith. The final payment shall be due within forty (40) days after all of these express condition precedent have been met. (emphasis added).

3. Company D

a. Payment in General

Notwithstanding any other provision of this Agreement, Construction Manager shall be under no obligation to make payment to the Contractor under any provision hereof except to the extent that General Contractor has received funds from Owner, payment by Owner being a condition precedent to payment to the Subcontractor. (emphasis added).

4. Company E

a. Progress Payments

Partial payments shall be due Subcontractor in the amount of 90% of the work in place, which work has been approved by General Contractor and the Owner, and for which payment has been made to General Contractor by the Owner. If the Contract Documents allow General Contractor partial payments for on-site stored materials, partial payments shall also be due Subcontractor in the amount of 90% of materials stored on-site which have been approved by General Contractor and the Owner and for which payment has been made to General Contractor by the Owner. Subcontractor's retention shall be reduced to the same extent General Contractor's retention is reduced by the Owner for the work of this Subcontract. If the Contract Documents allow partial payment for materials stored off-site, such payments shall be made to Subcontractor in the amounts and under the standards set forth in the Contract Documents for off-site stored materials which have been approved by General Contractor and the Owner but only after General Contractor's receipt of payment therefor from the Owner.

b. Final Payment

Final payment . . . shall not be due until Subcontractor's work has been completed and approved by the Owner, all final payment prerequisites under the Contract Documents have been satisfied, satisfactory proof of payment of all amounts owed by Subcontractor in connection with this Subcontract has been provided, . . . and General Contractor has been paid in full for the work of this Subcontract.

c. Other

At any time all monies due General Contractor from the Owner are not paid, General Contractor shall, in its sole discretion, apportion the nonpayment equitably and reduce the payments otherwise due Subcontractor accordingly. Such reductions shall continue until General Contractor is paid all monies due it, provided however, if the withholdings do not relate to Subcontractor's work, Subcontractor shall be paid in full when General Contractor's right to recover from the Owner is finally determined or expires. Subcontractor acknowledges that this Article establishes a reasonable time for payment.

5. Company F

a. Progress and Final Payment

Subcontractor agrees that Owner's payment to Contractor of all progress payments and final payment for any work performed by Subcontractor, other Subcontractors and Contractor shall be an express condition precedent to any obligation of Contractor to make any progress payments, retainages, or final payment to Subcontractor: provided (1) Subcontractor has valid lien rights against Owner and the project for the work for which Subcontractor has not received payment, (2) payment is not received due to no fault of

Contractor, and (3) Subcontractor is given the opportunity to exercise Contractor's rights under the Contract Documents pursuant to subparagraph _____. (emphasis added).

III. Recent Cases in The District of Columbia, Maryland and Virginia

A. District of Columbia

Urban Masonry Corporation v. N&N Contractors, Inc., 676 A.2d 26 (1996).

Urban Masonry Corporation ("Urban") hired N&N Contractors, Inc. ("N&N") as a sub-subcontractor to install welded precast concrete on a project in the District of Columbia. After completing its subcontract, N&N demanded full payment for the costs associated with extra work, delays, disruption, attorneys' fees and interest. N&N ultimately sued Urban for breach of contract. The trial court awarded N&N all of the damages claimed for the extra work, delays, disruption, attorneys' fees and interest, and Urban appealed that order to the District of Columbia Court of Appeals.

In reviewing the case, the appellate court, among other things, reviewed whether the trial court had properly awarded interest on the delay and disruption claim, despite a "pay-if-paid" clause in the subcontract. The subcontract clause at issue provided:

1(a) Payments will be made to the Subcontractor promptly as they are received. Receipt of payment by Contractor shall be a condition precedent to payment being owed to Subcontractor.

.....

1(e) Invoices for work performed by Subcontractor will be paid within five (5) days after receipt of the corresponding payment from General Contractor. Contractor shall, however, have the right to withhold funds necessary to repair or complete defective work. . . . Late payments shall bear an interest at the rate of ten percent (10%) per annum. . . . not beyond normal retention.

Relying on the subcontract language, Urban claimed that because it did not receive payment from the owner, it was not obligated to pay N&N. N&N countered Urban's arguments by noting that, prior to its filing suit, Urban had settled its claims with the general contractor. However, that settlement did not include N&N's claims even though Urban was contractually required to "pass-through" N&N's claims to the owner.

The court rejected Urban's arguments and explained that the condition precedent in the "pay-if-paid" clause was satisfied when Urban settled its claims against the general contractor. The court added that even if the settlement was not properly considered "payment" in satisfaction of the condition precedent, Urban breached its contract by failing to protect N&N's interests in the settlement agreement. The court pointed out that, at the time of settlement, Urban was aware of N&N's claim and of the "pay-if-paid" clause. Urban, however, agreed to a settlement that did not secure payment for N&N. As a result, it breached the implied duty to not frustrate the fulfillment of a condition precedent. The court concluded that Urban cannot benefit from that willful hindrance of the condition precedent. Therefore, the court held Urban liable for the breach and affirmed the trial court's award to N&N for damages.

B. Maryland

1. The Gilbane Cases:

Gilbane Bldg. Co. v. Brisk Waterproofing Co., 86 Md. App. 21, 585 A.2d 248 (1991); Architectural Systems, Inc. v. Gilbane Bldg. Co., 760 F. Supp. 79 (D. Md. 1991), summ. jmt. granted, 779 F. Supp. 820 (D. Md. 1991), aff'd without op., 974 F.2d 1330 (4th Cir. 1992), reported in full, 1992 U.S. App. LEXIS 21242 (4th Cir. 1992).

The Maryland courts have held that they will enforce unambiguous language unquestionably establishing that payment by the owner to the general contractor is an express condition precedent to the general contractor's obligation to pay the subcontractor. In the Gilbane Cases, Gilbane, as general contractor, entered into subcontracts with Architectural Systems and Brisk. The subcontracts contained identical condition precedent payment clauses which provided, "it is specifically understood and agreed that the payment to the trade contractor is dependent, as a condition precedent, upon the construction manager [Gilbane] receiving contract payments, including retainer from the owner." During the course of construction, the owner ceased making payments to Gilbane. Gilbane, in reliance on the condition precedent payment provisions in the subcontracts, ceased making payments to Brisk and Architectural Systems and refused to tender final payment because the owner had not made final payment to Gilbane. Although Brisk had obtained a mechanic's lien against the property, it could not enforce the lien due to foreclosure. The owner was ultimately forced into bankruptcy and Brisk and Architectural Systems then brought suit against Gilbane, the former in state court and the latter in federal court, seeking the sums due under the subcontracts.

Gilbane filed motions for summary judgment contending that the subcontracts clearly established that receipt of payment from the owner was a condition precedent to Gilbane's obligation to pay Brisk and Architectural Systems. In each of the Gilbane Cases the courts held that there could be no question that payment by the owner to the general contractor was a condition precedent to Gilbane's obligation to pay the subcontractor. Brisk, 86 Md. App. at 28; Architectural Systems, Inc., 760 F. Supp. at 81. Specifically, the Brisk court reversed the trial court's award to the subcontractor and held that the subcontract established that payment from the owner to the general contractor was a condition precedent to the general contractor's obligation to pay the subcontractor.

The Brisk court rejected the subcontractor's claim that the conditional payment clause simply "postpones" payment until "the happening of some certain event or for a reasonable period of time if such event does not occur." Id. The court rejected Brisk's attempts to rely upon other cases in making this argument because the payment language reviewed in such cases had not specifically created a condition precedent. Brisk, 86 Md. App. at 28-29, 585 A.2d at 251-52, distinguishing Atlantic States Constr. Co. v. Drummond & Co., 251 Md. 77, 246 A.2d 251 (1968)). The Brisk court noted that it could not ignore the unambiguous contract language before it. It further explained that regardless of whether the parties discussed the possibility of the insolvency of the owner, "the objective meaning is clear . . .", that the clause makes receipt of payment by the general contractor a condition precedent to its obligation to pay the subcontractor. The court added that the clause effectively transfers "from the general contractor to the subcontractor the credit risk of non-payment by the owner for any reason (at least for any reason other than the general contractor's own fault), including insolvency of the owner." 86. Md. App. at 28-29, 585 A.2d at 252.

The Gilbane courts did not address how they would construe the clauses in conjunction with mechanic's lien and payment bond laws.

2. Maryland Code

Subsequent to the Gilbane Cases, Maryland's General Assembly enacted a statute which invalidates conditional payment clauses if the clause conflicts with a subcontractor's right to file a mechanic's lien or maintain a payment bond action. Maryland Real Property Code, Sections 9-113 (b) and (c) now provide that:

(b) Provisions conditioning payment to subcontractor on payment of contractor. - A provision in an executory contract between a contractor and a subcontractor that is related to construction, alteration, or repair of a building, structure, or improvement and that conditions payment to the subcontractor on receipt by the contractor of payment from the owner or any other third party may not abrogate or waive the right of the subcontractor to:

- (1) Claim a mechanics' lien; or

(2) Sue on a contractor's bond.

(c) Void provisions. - Any provision of a contract made in violation of this section is void as against the public policy of this State. (1981, ch. 756; 1994, ch. 626; 1995, ch. 3 § 1.)

It should be noted, however, that the code provision only applies to subcontracts entered into on or after October 1, 1994.

C. Virginia

Galloway Corp. v. S.B. Ballard Constr. Co., 250 Va. 493, 464 S.E. 2d 349 (1995).

The Virginia Supreme Court has held that a general contractor, via a pay-when-paid clause in a subcontract, can shift the risk of the owner's default in payment from the general contractor to the subcontractors. The parties in this case had executed a preprinted AIA subcontract (AIA 401) which originally only provided that:

The Contractor shall pay the Subcontractor each progress payment within three working days **after the Contractor receives payment from the Owner**. If the Architect does not issue a Certificate of Payment or the Contractor does not receive payment for any cause which is not the fault of the Subcontractor, the Contractor shall pay the Subcontractor, on demand, a progress payment computed as provided in Paragraphs 11.7 and 11.8. (Emphasis in original).

and

Final payment, constituting the entire unpaid balance of the Subcontract Sum, shall be made by the Contractor to the Subcontractor when the Subcontractor's Work is fully performed in accordance with the requirements of the Contract Documents, the Architect has issued a Certificate of Payment covering the Subcontractor's completed Work **and the Contractor has received payment from the Owner**. If, for any cause which is not the fault of the Subcontractor, a Certificate for Payment is not issued or the Contractor does not receive timely payment or does not pay the subcontractor within three working days after receipt of payment from the Owner, final payment to the Subcontractor shall be made upon demand. (emphasis in original).

However, in each clause, the general contractor struck out all of the language following the word "Owner" and initialed the change. Thus, the subcontracts provided only that the general contractor "shall pay the Subcontractor each progress payment within three working days after the Contractor receives payment from the Owner," and that final payment would be made "when the Subcontractor's work is fully performed . . . , the Architect has issued a Certificate of Payment covering the Subcontractor's completed Work and the Contractor has received payment from the Owner."

During the project, the owner ceased making payments to the general contractor. As a result, the general contractor terminated its contract with the owner. The general contractor, as well as several subcontractors, filed suits against the owner to enforce their mechanic's lien rights. The subcontractors also sued the general contractor for failing to pay for labor and materials. The trial court consolidated all of the suits and ultimately entered judgment in favor of the claimants on their mechanic's liens and also in favor of the subcontractors against the general contractor.

On appeal, the Virginia State Supreme Court considered the effect of conditional payment clauses for the first time. The court reviewed case law in other jurisdictions and concluded that a general contractor may shift the risk of owner insolvency to the subcontractors through the use of clear contract language. However, the court concluded that the clause at issue did not convey a clear intent and contained a "latent ambiguity" as to the payment terms. The court held that in the absence of a clear and

unambiguous statement of the parties' intent as to the time of payment, an absolute pay-when-paid defense is available to a general contractor only if it can establish by parol evidence that the parties mutually intended the contract to create such a defense. As a result, the court considered extrinsic evidence of the parties' intentions regarding the conditional payment clauses, and concluded that all but one subcontractor had contemplated the conditional payment defense that the general contractor asserted. Therefore, it reversed the trial court awards to all of the subcontractors with the exception of that one subcontractor.

IV. Recent Cases From Other Jurisdictions

A. California

Wm. R. Clarke Corp. v. SAFECO Ins. Co., 38 Cal. App. 4th 1655, 46 Cal. Rptr. 2d 183 (2d Dist. 1995), modified, 39 Cal. App. 4th 1210 (2d Dist. 1995), review granted, 49 Cal. Rptr. 2d 413, 909 P. 2d 1017 (1996).

After reviewing a subcontractor's claims for payment, a California court held that: 1) a pay-when-paid clause which provided that, "Receipt of funds by Contractor from Owner is a condition precedent to the Contractor's obligation to pay Subcontractor under this Agreement, regardless of the reason for Owner's nonpayment, whether attributable to the fault of the Owner, Contractor, Subcontractor or due to any other cause," did not affect subcontractor's right to recover on payment bond; 2) a statute prohibiting a surety's obligation from being larger and more burdensome than that of principal did not apply to the case at bar; 3) a dispute with regard to a part of a claim did not render the claim uncertain and therefore did not preclude the subcontractor from recovering prejudgment interest; and 4) the subcontractor was not entitled to a two percent penalty for the general contractor's lack of timely payment. The court noted that although the subcontractor had explicitly assumed the risk of the owner's failure to pay, its subcontract also provided, in an addendum, that nothing would be interpreted as limiting the subcontractor's rights to enforce its statutory mechanic's lien rights or remedies. The terms of the payment bond provided that if the general contractor failed to pay a subcontractor who had recorded a mechanic's lien or who had otherwise given notice to the surety, the surety would pay the subcontractor's claim. Thus, the court determined that under the plain language of the contract and the payment bond, the surety had waived its rights to challenge the claim.

B. Florida

OBS. v. Pace Constr. Corp., 558 So.2d 404 (Fla. 1990).

A drywall subcontractor sued a general contractor and a payment bond surety for payment after the owner failed to pay the general contractor. The court reviewed the following language, "Final Payment shall not become due unless and until the following conditions precedent to Final Payment have been satisfied: . . . (c) receipt of Final Payment for Subcontractor's work by Contractor from Owner. . . ." In reviewing the case, the Florida Supreme Court reiterated that it construes subcontract payment provisions as a matter of law. Furthermore, although in most cases, the owner's payment to the general contractor is not a condition precedent to the general contractor's duty to pay the subcontractors, the parties may shift the risk of owner nonpayment to the subcontractor. However, in order to shift the risk, the contract must unambiguously express such an intention. The court went on to state that because the subcontract referred to the general contract, the court was required to review both the subcontract and general contract. In reviewing the two contracts together, the court concluded that there existed a patent inconsistency with respect to the parties' intentions. The general contract required the general contractor to pay its subcontractors before the owner would reimburse it. The subcontract, on the other hand, required the general contractor to pay the subcontractor only after payment by the owner. The court concluded that, in construing purported risk-shifting provisions, the general contractor bears the burden of clear and unequivocal expression. When the court determines an ambiguity exists, such ambiguity must

be construed against the general contractor and the payment provision must be interpreted as establishing a reasonable time to pay, rather than a condition precedent.

(The court added that even if the clause had effectively shifted the risk of owner insolvency or non-payment to the subcontractor the clause would not affect the subcontractor's payment bond claim. Because the bond in this case was filed to replace the subcontractor's mechanic's lien rights, the clause could not affect the subcontract's rights. The court noted that to hold otherwise would "thwart the entire purpose and scheme of the mechanic's lien law and statutes allowing a bond in lieu of exposure to liens." Id. at 408.)

DEC Electric, Inc. v. Raphael Constr. Corp., 558 So. 2d 427 (Fla. 1990).

An electrical subcontractor unsuccessfully sued a general contractor for monies owed when general contractor refused to pay because it had not been paid by the owner. The court reviewed a clause which provided that, "[n]o funds will be owed to the subcontractor unless the General Contractor is paid by the Owner The subcontractor fully understands that in the event of non-payment by the Owner to the General Contractor, the subcontractor has legal recourse against the Owner through the Mechanic's Lien Laws or other legal procedures for their correct monies due." The Florida Supreme Court held that it would determine the parties' intentions as a matter of law, because the relationship between a general contractor and subcontractor typically does not differ from transaction to transaction. When a contract unambiguously shifts the risk of non-payment from the general contractor to the subcontractor, the court will conclude that, as a matter of law, that the parties intended to create a condition precedent to payment. Furthermore, the court added that when a contract provision, as a matter of law, is ambiguous, the court will conclude that the parties intended to establish a reasonable time for payment.

C. Illinois

Premier Electrical Constr. Co. v. American National Bank of Chicago, 656 N.E. 2d 157 (Ill. App. 1st Dist. 1995).

An electrical subcontractor filed mechanic's lien, payment bond and breach of contract claims for payment due. It argued that, under the terms of the contract, the general contractor was required to pay the subcontractor within three months after the subcontractor completed its work. The general contractor claimed that it was not required to pay the subcontractor until it received payment from the owner (who had filed bankruptcy). The court reviewed the following language, "[i]f the subcontractor is making satisfactory progress with the work, is not in default and complies with all the documentation requirements of this Agreement, and if the General Contractor . . . has received payment from the owner for such Work, the General Contractor will make monthly payments to the Subcontractors. . . ." However, the disputes provision of the subcontract also provided that, "[i]f a conflict arises between Owner and General Contractor . . . this subcontractor will receive payment in a timely manner just as if the conflict did not exist" The court ruled that, although there was a pay-when-paid clause in the contract, it was superseded by the disputes provision. The court concluded that if language of a contract clearly and unambiguously creates an exception to a pay-when-paid clause, the court will enforce the exception.

D. Kansas

Shelley Electric, Inc. v. United States Fidelity & Guaranty Co., 1992 WL 319654 (D. Kans. 1992).

A federal court considered the validity of a conditional payment clause. The court granted an electrical subcontractor's motion for partial summary judgment in an action involving a state penitentiary project. The court reviewed a conditional payment clause which provided, in pertinent part, that "[p]ayment shall be made to Subcontractor within ten days after payment has been received by Contractor respecting such work or material, less any applicable percentage thereof retained in accordance with the aforesaid General Contract." Although Kansas state courts had never interpreted the clause at issue, the court followed the majority rule and stated that the clause merely fixed a reasonable time for payment. It noted

that there was no express condition precedent language or use of terms like “if” or “unless”. Therefore the court concluded that the general contractor’s receipt of payment from the owner was not a condition precedent to its obligation to pay the subcontractor.

E. Massachusetts

Canam Steel Corp. v. Bowdoin Constr. Corp., 34 Mass. App. Ct. 943, 613 N.E.2d 121 (1993).

A steel supplier successfully sued a general contractor for payment due on materials supplied to a subcontractor. The general contractor argued that the supplier was subject to the pay-when-paid clause of the subcontract which it had referenced in a letter agreement. At the end of the letter, the general contractor stated that it would make the payment under the terms and conditions of the subcontract. The subcontract provided, “[r]eceipt of payment by the Contractor shall be a condition precedent to any payment to the subcontractor hereunder.” The court noted that in Massachusetts, pay-when-paid provisions are not effective unless clearly expressed. It refused to enforce the provision at issue and added that the provision in the letter which purported to incorporate the subcontract did not sufficiently incorporate the pay-when-paid clause into the joint check agreement.

F. Michigan

Berkel & Co. Contractors v. Christman Co., 210 Mich. App. 416, 533 N.W.2d 838 (1995).

A subcontractor challenged a trial court’s decision that it was not entitled to any payments on its account because the owner had not yet paid the general contractor. The Michigan Court of Appeals held that the conditional payment clause was unambiguous, fully enforceable, and could not be read to merely postpone payment for a “reasonable” period. In the project that gave rise to Berkel, the owner commenced work prior to obtaining financing, and eventually could not pay either the general contractor or the subcontractors. The subcontractor claimed that a provision in its bid proposal required payment within thirty days following completion of the subcontractor’s work. The court rejected that argument because the subcontract in question did not incorporate the portions of the bid proposal that dealt with payment. The court focused only on the subcontract, which stated that the general contractor’s payment by the owner was “a condition precedent to payments to the subcontractor.” The court held that the pay-when-paid clause was so clear and unambiguous that it created a definite bar to the subcontractor’s right to be paid. The court added that even if the bid proposal had been fully incorporated into the subcontract, the bid proposal was ambiguous as compared to the subcontract. Therefore, the court still would have held that the conditional payment clause superseded the payment terms contained in the bid proposal. The subcontractor also argued that conditional payment clauses merely allow a general contractor to postpone payment for a “reasonable” amount of time. The court disagreed, and stated that when a pay-when-paid clause makes the general contractor’s payment a condition precedent to subcontractor payment, “[f]ailure to satisfy a condition precedent prevents a cause of action for failure of performance.” Because the pay-when-paid clause did not contain any language limiting the condition precedent to a reasonable amount of time, the court refused to read the limitation into the clause. As a result, the court concluded that the subcontractor had no right of action for payment until the owner paid the general contractor.

G. Minnesota

Mrozik Constr. Inc. v. Lovering Assocs., Inc., 461 N.W. 2d 49 (Minn. Ct. App. 1990)

In a case of first impression, a Minnesota court affirmed summary judgment in favor of a concrete/masonry subcontractor who sued a general contractor for amounts due on its subcontract. The general contractor unsuccessfully contended that it was not obligated to pay the subcontractor because the insolvent owner had not paid it. The conditional payment clause in the subcontract provided that, “[f]inal payment including all retention becomes due and payable within 30 days after Architects’ certification of final payment. At all times the subcontractor shall be paid to the extent that the Contractor

has been paid on the Subcontractor's account." The court adopted the majority view and held that it would not construe a subcontract as creating a condition precedent to the general contractor's obligation to pay to the subcontractor unless the parties expressed such intent in plain, unequivocal, and unambiguous language. It concluded that the language of the subcontract failed to unequivocally shift the risk of the owner's insolvency to the subcontractor, and therefore it construed the language to mean merely that the general contractor must not delay in paying the subcontractor after it received funds from the owner.

H. New York

West-Fair Electric Contractors v. Aetna Casualty and Surety Co., 87 N.Y. 2d 148 (1995).

The Court of Appeals of New York (the state's highest court) ruled that complete risk-shifting pay-when-paid provisions in construction subcontracts violate the state's public policy and are therefore unenforceable. In West-Fair, a subcontractor had substantially completed its contractual work on a project when the project owner became insolvent. The project owner's insolvency caused the general contractor to cease making payments to the subcontractor, who then sued the general contractor and its surety for breach of contract in federal court. In the federal court proceeding, the general contractor raised the pay-when-paid clause in the subcontract as a defense to the subcontractor's breach of contract action. The pay-when-paid clause in the subcontract expressly stated that the subcontractor's right to payment would be "dependent, as a condition precedent" upon the general contractor's receiving payment, including retainage, from the owner. The federal trial court issued judgment in favor of the subcontractor, and on appeal, the Federal Circuit Court of Appeals certified the question of whether pay-when-paid clauses are enforceable in New York to the state's highest court. On certification, the New York Court of Appeals stated that the words "condition precedent" in the clause at issue absolutely shifted the risk of the owner's failure to pay to the subcontractor. The court contrasted the "condition precedent" provisions, with pay-when-paid provisions that merely fix a time for payment. "Time-fixing" conditional payment provisions operate to make the subcontractor's payment due on the same date that the owner pays the general contractor. Such provisions, however, do not totally shift the risk of owner non-payment or default to a subcontractor because under "time-fixing" provisions, a subcontractor must be paid within a "reasonable time" after project completion, even if the owner has not yet paid the general contractor.

The Court examined the absolute risk-shifting conditional payment provision at issue, in light of Article 2, § 34 of New York's mechanic's lien law which states, in pertinent part, that "any contract, agreement or understanding whereby the right to file or enforce any lien created . . . is waived, shall be void as against public policy and wholly unenforceable." (Emphasis added). In light of that statute, the Court ruled that any conditional payment provision forcing the subcontractor to assume the risk of owner nonpayment is void, unenforceable and contrary to public policy. The court added, however, that "time-fixing" pay-when-paid provisions which do not remove the basic right to payment do not violate public policy and will continue to be enforced.

I. North Carolina

Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118 (W.D. N.C. 1988).

A roofing and heating subcontractor sued a general contractor for payment due. The sole issue was whether a pay-when-paid clause in the contract established a condition precedent to the subcontractor's right to payment. The clause at issue provided, "Final payment shall be paid to the Subcontractor . . . conditioned upon payment having been received by the Contractor for all of Subcontractor's Work" The court refused to enforce the conditional language, and followed North Carolina state law. It held that the pay-when-paid clause in the subcontract did not make payment by owner a condition precedent to subcontractor's collection of sums.

J. Ohio

Power & Pollution Services, Inc. v. Suburban Power Piping Corp., 74 Ohio App. 3d 89, 598 N.E. 2d 69 (Ohio App. 8th Dist. 1991).

A subcontractor successfully brought an action against a general contractor to recover monies owed for services rendered and argued that the pay-when-paid clause in the subcontract did not create a condition precedent. The subcontract provided that the general contractor “shall not be required to pay any such monthly billing of the subcontractor prior to the date [it] receives payment of its corresponding monthly billing from the Owner Within ten (10) days after said final payment by the Owner, Company shall pay the subcontractor the balance of the subcontract sum.” In a case of first impression, the court adopted the majority rule and concluded that the provision at issue did not create a condition precedent to the general contractor’s duty to pay the subcontractor. Rather, the clause was an absolute promise to pay within a reasonable time. Furthermore, the court explained that if the parties intended to shift the risk of owner insolvency to the subcontractor, the parties should have unambiguously expressed their intention in the contract.

K. Tennessee

Koch v. Construction Technology, Inc., 1996 Tenn. LEXIS 320 (1996).

A painting subcontractor on a public housing development project sued a general contractor for breach of contract after the general contractor refused to pay the subcontractor. The trial court had concluded that the general contractor was not required to pay the subcontractor because the subcontract contained a “pay-when-paid” clause, and the owner had not yet paid the general contractor. The general contractor appealed that decision to the Supreme Court of Tennessee.

The subcontract at issue contained, in pertinent part, the following language:

Partial payments subject to all applicable provisions of the Contract shall be made when and as payments are received by the Contractor. The Subcontractor may be required as a condition precedent to any payment to furnish evidence satisfactory to the Contractor that all payrolls, material bills, and other indebtedness applicable to the work have been paid.

Although the court had never reviewed such a clause, it noted that there were several tenets of Tennessee law which provided guidance on the issue. For instance, it explained that condition precedents are not favored in the law and will be upheld only where there is clear language. Also, the court observed that the majority of jurisdictions construe the clauses as simply affecting the timing of payments rather than shifting the risk of owner nonperformance to the subcontractor. In light of those rules and of the rationale provided in other jurisdictions, the court concluded that the language in the case did not create an enforceable condition precedent to payment. The court added that in another clause of the subcontract, the parties clearly established a condition precedent and thus illustrating that they knew how to do so, but failed to do so in the payment clause. The court, as a result, held that the general contractor was obligated to pay the subcontractor even though it did not receive payment from the owner.