

# Contingent Clauses Place Payment in Jeopardy

**M**ore than ever, construction subcontractors are being asked to sign subcontracts with a clause that legally prevents them from collecting payment if the owner fails to pay the general contractor.

These objectionable contract clauses are referred to by many names, including *contingent payment*, *condition precedent*, *pay-when-paid*, *pay-if-paid*, and *pay-when-and-if-paid*. Whatever the name, their purpose is the same—to shift the risk of nonpayment by the owner from the general contractor to the subcontractor. A subcontractor who agrees to such a contract may never get paid.

This article reviews the types of contingent payment clauses a subcontractor is likely to encounter and provides general guidelines on how to deal with them. Subcontractors are encouraged to discuss how this information applies to their specific contracts with their attorneys.

## Pay-When-Paid Clauses

Until recently, a pay-when-paid clause was the type of contingent payment clause most likely to appear in a subcontract. A typical pay-when-paid clause may read:

*The Subcontractor shall be paid within seven (7) days after the General Contractor receives payment from the Owner for the work of the Subcontractor.*

Although not ideal, such clauses may not be harmful as long as the subcontract still entitles the subcontractor to payment. Courts in most states have held that a subcontractor may recover under a pay-when-paid clause, even when the general contractor has not been paid by the owner. These courts have ruled that pay-when-paid language establishes a timing mechanism for subcontractor payment; it does not breach the subcontractor's entitlement to payment.

However, when confronted with a payment dispute, a general contractor is likely to read the subcontract language literally and attempt to deny payment to the subcontractor. Surety companies also have seized upon pay-when-paid language as a defense, claiming surety has no obligation

to pay the subcontractor under the payment bond if the general contractor was not paid by the owner.

It also should be noted that a few courts have interpreted pay-when-paid language literally. They have ruled that the clause is an absolute bar to subcontractor payment unless the general contractor received payment from the owner or the subcontractor could prove that the failure of payment was the fault of the general contractor.

## Pay-If-Paid Clauses

More serious than the pay-when-paid clause is the pay-if-paid or the pay-when-and-if-paid clause. Lately, general contractors are using such clauses to protect themselves from court rulings entitling subcontractors to payment. Such clauses make it clear that a subcontractor will be paid only if the general contractor receives payment from the owner.

Pay-if-paid language may read something like this:

*The General Contractor will pay the Subcontractor only if the General Contractor is paid by the Owner for the Subcontractor's work. Receipt of payment from the Owner is an absolute condition precedent to the Subcontractor's right to payment.*

## Negotiating a Payment Clause

The best approach a subcontractor can take when faced with a contingent payment clause is to cross out the language which makes the subcontractor's right to payment contingent on payment by the owner. Ideally, the subcontractor should substitute language that establishes firm payment dates. The progress payment clause should state a set date by which the contractor is to be paid. For example:

*The Subcontractor will be paid monthly progress payments on or before the 15th of each month for the value of the work completed and the value of stored materials, suitably stored on- or off-site during the preceding month.*

If a general contractor insists on contin-

gent payment language, the subcontractor must make certain that the subcontract does not bar the subcontractor's entitlement to payment for any reason other than the subcontractor's deficiencies. There are a number of ways a subcontractor can assure it is entitled to payment. One of the best methods is the following modification:

*Our acceptance of the conditional payment terms is conditioned on the understanding that those terms apply solely to monies withheld by the Owner due to some deficiency on our part.*

Another way is to add a clause limiting the general contractor's right to withhold payment to 30 or 60 days, even if the owner does not pay the general contractor.

Also, a savings clause clearly establishes that the subcontractor will be paid if the general contractor is not paid by the owner, or the architect does not certify the work, for any reason that is not the fault of the subcontractor. For example:

*If the Architect fails to 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, progress payments and the final payment.*

This clause is similar to one that appears in Articles 11.3 (Progress Payments) and 12.1 (Final Payment) of the American Institute of Architects' Document A401, *Standard Form of Agreement Between Contractor and Subcontractor* (1987 edition).

If the general contractor insists on contingent payment language, a subcontractor should think twice about signing. Remember, a subcontractor who signs a contingent payment clause assumes the risk for the owner's financial soundness as well as the general contractor's and other subcontractors' performance.

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