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Contingent Payment Frequently Asked Questions

Subcontractors continue to report that one of the most objectionable subcontract provisions they face is a clause that legally prevents them from collecting payment if the owner fails to pay the prime contractor even though the reason for nonpayment has nothing to do with the subcontractor's work.

These objectionable contract clauses are referred to by a number of 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 prime contractor to the subcontractor.

Many subcontractors have difficulty walking away from a project, regardless of the onerous provisions contained in the related subcontract. The fact is that once the prime contractor has reached an agreement with the owner, it is a monopsonist; that is, the prime contractor is the single buyer of the subcontractor's service for that project and thus is able to exercise disproportionate influence in agreements with its subcontractors and suppliers. Yet a subcontractor who agrees to a subcontract that makes payment completely contingent on payment by the owner to the prime contractor may never get paid.

The purpose of this FAQ is to review the types of contingent payment clauses a subcontractor is likely to encounter and provide general guidelines on how to deal with them. This FAQ provides educational information rather than legal guidance. Subcontractors are encouraged to discuss with their attorneys how this information applies to their specific subcontracts.

What is a "pay-when-paid" clause?

A "pay-when-paid" clause was, until the mid-1980's, the type of contingent payment clause most likely to appear in a subcontract. These clauses address when a prime contractor must pay its subcontractors. For example, a typical "pay-when-paid" 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.

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Payment clauses like that are common. What's so bad about them?

The answer may be nothing, as long as the subcontract still entitles the subcontractor to payment. Courts in many states have held that a subcontractor may collect payment 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.

If the courts have ruled that a subcontractor is entitled to payment even if the owner hasn't paid the prime contractor, then what's the problem?

When confronted with a payment dispute, a prime contractor is likely to read the subcontract literally and attempt to deny payment to the subcontractor. This may include using the contingent payment clause as a defense against a subcontractor's mechanics lien claim.

Surety companies also have seized upon "pay-when-paid" language as a defense, claiming the surety has no obligation to pay the subcontractor under the payment bond. The last thing a subcontractor wants is to go to court to override a contingent payment clause to collect payment.

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 prime contractor has received payment from the owner.

What is the difference between a "pay-when-paid" clause and a "pay-if-paid" clause or a "pay-when-and-if-paid" clause?

Many prime contractors use "pay-if-paid" and "pay-when-and-if-paid" clauses to protect themselves from court rulings entitling subcontractors to payment when an owner has not paid them. Such clauses make clear that a subcontractor will be paid only if the prime contractor receives payment from the owner. These clauses truly make owner payment to the prime contractor a condition precedent to the prime contractor paying the subcontractor.

"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 Subcontract Work. Receipt of payment from the Owner by the General Contractor for the Subcontract Work is an absolute condition precedent to the Subcontractor's right to payment.

If I shouldn't sign a "pay-when-paid" or "pay-if-paid" clause, what kind of payment should I sign?

Ideally, the subcontract should establish firm dates on which the subcontractor will be paid. The progress payment clause should state a set date of the month by which the contractor is paid. For example, a progress payment clause should provide:

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

What does ConsensusDocs say about contingent payment clauses?

ConsensusDocs assures a subcontractor entitlement to payment except where the contractor does not receive payment due to the fault of the subcontractor.

ConsensusDocs Form 750, Standard Agreement Between Constructor and Subcontractor (2011), ¶ 8.2.5. states:

TIME OF PAYMENT Progress payments to the Subcontractor for satisfactory performance of the Subcontract Work shall be made no later than seven (7) Days after receipt by the Constructor of payment from the Owner for the Subcontract Work. If payment from the Owner for such Subcontract Work is not received by the Constructor, through no fault of the Subcontractor, the Constructor will make payment to the Subcontractor within a reasonable time for the Subcontract Work satisfactorily performed.

How does the American Institute of Architects address subcontractor entitlement to payment?

The American Institute of Architects' *Form A401, Standard Form of Agreement Between Contractor and Subcontractor (2007)*, also assures a subcontractor entitlement to final payment except where the contractor does not receive final payment due to the fault of the subcontractor.

§ 11.3 Provided an application for payment is received by the contractor not later than the _____ day of a month, the Contractor shall include the Subcontractor's Work covered by that application in the next application for payment which the Contractor is entitled to submit to the Architect. The Contractor shall pay the Subcontractor each progress payment no later than seven 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 Sections 11.7, 11.8 and 11.9.

What if I'm presented with a subcontract that contains a contingent payment clause?

The best approach is for the subcontractor to cross out the language which makes the subcontractor's right to payment contingent on payment by the owner.

What if the prime contractor insists on language that the subcontractor will be paid only after and if the prime contractor receives payment?

If a prime contractor insists on contingent payment language, the subcontractor should make certain that the subcontract does not bar the subcontractor's entitlement to

payment if the owner fails to pay the prime contractor for any reason other than the subcontractor's deficiencies.

How do I do that?

There are a number of ways a subcontractor can assure that it is entitled to payment. One of the best methods, which is an acceptable clarification to many prime contractors, is the following modification:

Subcontractor 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 of the Subcontractor's Work.

Another way would be for the subcontractor to add a clause limiting the prime contractor's right to delay payment to 30 days or 60 days, even if the owner does not pay the prime contractor.

A subcontractor also can add a savings clause that clearly establishes that the subcontractor will be paid by the prime contractor if the prime contractor is not paid by the owner or the architect does not clarify the work for any reason that is not the fault of the subcontractor. For example:

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

What if the prime contractor refuses to accept any of these suggested changes to the subcontract?

If the prime contractor insists on contingent payment language, a subcontractor should think twice about signing the subcontract. Remember, a subcontractor that signs a contingent payment clause assumes the risk for both the owner's financial soundness and the prime contractor's and even other subcontractors' performance.

Let's say I decide to sign a subcontract with a strict contingent payment clause and no savings clause. Is there anything I can do to protect myself?

There are a number of steps a subcontractor can take before signing any subcontract, but particularly one with contingent payment language.

First, a subcontractor should review all aspects of the subcontract's payment clauses, including progress payments, retainage, payment for stored materials, payment for changed and extra work, and final payment. Each of these should be written to maximize cash flow for the subcontractor.

What else can I do?

As with all projects, a subcontractor should assure that a project owner has made the financial arrangements to fulfill its obligations and that procedures have been

established to assure that contractors will receive timely payments. Both ConsensusDocs and the AIA require the owner to furnish evidence to the prime contractor that it has the financial resources to fulfill its obligations. A subcontractor should ask the prime contractor to provide it with this information.

Other sources of information on construction owners include architects and prime contractors that have worked for the owner before, Dun & Bradstreet, and credit reports, which your bank may be able to provide. Of course, you can also find a significant amount of information with a simple Internet search.

A subcontractor also should investigate the financial status of the prime contractor. In addition to the sources cited above, an ASA member may want to contact its local ASA chapter to access information through its Business Practices Interchange.

A subcontractor should carefully review the information it collects before deciding to sign a subcontract.

Is there anything else I can do?

At least one more thing. A subcontractor should make sure that its subcontract assures that it can stop work for nonpayment. The following is an example of such language:

Should Subcontractor's payment be delayed because (a) Customer fails to receive timely payment of amounts certified and approved, or (b) Customer fails to make timely payment after receiving payment for Subcontractor's work, then Subcontractor may suspend work after giving at least seven (7) days written notice to Customer of the intent to suspend and the date of intended suspension. Should Subcontractor's work be thereafter suspended for at least twenty-one (21) days, Subcontractor may terminate this subcontract upon written notice of termination to Customer.

If a subcontractor does not get paid for work performed, it has incurred a great expense without compensation. If the subcontract does not permit the subcontractor to stop work for non-payment, it may be faced with the prospect of continuing work and incurring further expenses, perhaps with no prospect for being paid.

What is ASA doing about contingent payment clauses?

ASA is working to educate all the members of the construction team about the inequities of pay-if-paid clauses. In addition to documents like this one, ASA has a broad range of educational materials to help subcontractors learn how to preserve their payment rights. These include the following documents that are available at to ASA members at www.ASAonline.com:

- *ASA Negotiating Tip Sheet: Pay-if-Paid Clause (2013).*
- *Contingent Payment Clauses in the 50 States (2014).*
- *Protecting Against Payment Default (2009).*

ASA also has a robust advocacy effort to make pay-if-paid clauses against public policy and thus unenforceable. This includes both legislative initiatives and judicial action

when appropriate. To find out what you can do to help with ASA's advocacy efforts, contact your ASA local chapter, review ASA's legislative work kit *Eliminating Pay-if-Paid Clauses in Your State*, or contact ASA's *Subcontractors Legal Defense Fund*.