MURTHA CULLINA

NEWS ALERT

CONSTRUCTION GROUP

Extremely Clear Pay-If-Paid Clause is Enforced

By Michael J. Donnelly | January 2, 2018

Every contract involves the risk of insolvency, and every construction subcontract involves the risk of the owner/developer failing to make the payments that the contractor intends to use to pay its subcontractors. Frequently, general contractors seek to shift this risk onto their subcontractors through the use of clauses which describe payment from the owner to the contractor as a condition precedent to payment to the subcontractor. Simply put, when the contractor is successful in shifting the risk to the subcontractor, the clause is known as "Pay-If-Paid". If contract language is not sufficient to transfer the risk, the clause is viewed as "Pay-When-Paid". A Pay-When-Paid clause merely defers the timing of the payment due to the subcontractor until the contractor has been paid by the owner, or some reasonable time after the work was performed even if payment has not been made to the contractor.

The question of whether a contract involved a Pay-If-Paid clause was recently litigated under Connecticut law in the Superior Court in Baker Concrete Const. v. A. Poppajohn Co., 2017 WL 4106383. In that case, the parties had signed an agreement which provided that

> The Subcontractor expressly acknowledges and agrees that payments to it are contingent upon the Contractor receiving payments from the Owner. The Subcontractor expressly accepts the risk that it will not be paid for the Work performed by it if the Contractor, for whatever reason, is not paid by the owner for such Work. The Subcontractor states that it relies primarily for payment for Work performed on the credit and ability to pay off [sic] the Owner and not of the Contractor, and thus the Subcontractor agrees that payment by the owner to the Contractor for work performed by the Subcontractor shall be a condition precedent to any payment obligation of the Contractor to the Subcontractor.

The plaintiff subcontractor argued that the clause was unenforceable as a risk-shifting provision based on its interpretation of a series of Connecticut cases. However, upon review, the Court distinguished the case law upon which the subcontractor relied as either involving public jobs or involving clauses which were more ambiguous than the one in the parties' contract here. Judge Povodator specifically relied on the contract language that provided "The Subcontractor expressly accepts the risk that it will not be paid for the Work performed by it if the Contractor, for whatever reason, is not paid by the owner for such Work" and "the Subcontractor agrees that payment by the owner to the Contractor for work performed by the Subcontractor shall be a condition precedent to any payment obligation of the Contractor to the

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Subcontractor" in determining that there was no ambiguity as to what these parties intended. In making this determination, however, Judge Povodator did question as to whether such risk shifting would be permissible under Connecticut law on a public job.

Takeaways

This case once again emphasizes the need for clear contract language to effectively transfer or share the risk on nonpayment downstream. General contractors that wish to share with subcontractors the exposure for an owner's failure to pay must ensure that their subcontracts contain clear and enforceable Pay-If-Paid language such as the language in the subcontract at issue in this case. On the other hand, subcontractors that believe that the general contractor should bear the risk of the owner's failure to pay must negotiate the removal of "Pay-If-Paid" language from their subcontracts.

If you have questions about mitigating the risk of insolvency in your construction contracts, please contact any member of the Murtha Cullina Construction Group.

If you have any questions regarding the information included in this bulletin, please contact: Michael J. Donnelly at mdonnelly@murthalaw.com or 860.240.6058

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