

Pay-if-Paid Clauses in Construction Subcontracts

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A Standard Clause providing clear and unequivocal language confirming the intent to shift the risk of nonpayment to a subcontractor or other lower-tier contractor on a construction project for use in states where pay-if-paid clauses are not prohibited by statute or case law. This Standard Clause contains integrated notes with important explanations and drafting tips to understand how a contractor can protect itself from an owner's nonpayment.

READ THIS BEFORE USING DOCUMENT

SCOPE OF STANDARD CLAUSE

This Standard Clause provides clear and unequivocal language for a payment provision in a subcontract to confirm that a subcontractor, or other lower-tier contractor, assumes the risk of nonpayment from the owner or upper-tier contractor. In those jurisdictions where a "pay-if-paid" provision is not void as against public policy, this clause:

Clearly confirms that the upper-tier contractor is not obligated to make payment to the lower-tier subcontractor if it is not paid by the owner (or other upper-tier contractor) for the work performed by the lower-tier contractor.

- Provides that receipt of payment from the owner or other upstream party is a condition precedent to the obligation to pay the lower-tier contractor.
- Expressly states that the lower-tier contractor is relying on the creditworthiness of the owner or other upstream party for payment.

For a discussion of the differences between, and enforceability of, pay-if-paid and pay-when-paid clauses, see *Practice Note, Pay-if-Paid vs. Pay-when-Paid in Construction Contracts* (<http://us.practicallaw.com/9-604-7025>).

WHERE TO USE THIS STANDARD CLAUSE

This clause may be added to any subcontract, whether between a contractor and its subcontractor or a subcontractor and its sub-subcontractor. It is customarily added to an article in a contract addressing the contractor's (or subcontractor's) obligation to make payments to the lower-tier contractor. It usually encompasses the obligation to make all of the following payments:

- Progress payments for work performed.
- Payment on final completion of the subcontractor's work or of the project.
- Partial or final release of retainage.

ASSUMPTIONS

This Standard Clause assumes that the construction contract is between a general or prime contractor (contractor) and a subcontractor. This clause can also be used in a contract between:

- A contractor and a supplier.
- A subcontractor and a sub-subcontractor or supplier.

Certain terms that are capitalized in this Standard Clause are defined elsewhere in the contract, such as Owner, Contractor, Subcontractor, Subcontract, Work, and Contract Documents.



1. Notwithstanding any provision to the contrary, except where the failure to receive payment is the result of default by the Contractor in the performance of its obligations under the Contract Documents unrelated to the Subcontractor's performance of the Subcontract, all payments by the Contractor to the Subcontractor under the Subcontract, including without limitation, progress payments, partial or full release of retainage, payment for change orders and final payment, are expressly and unequivocally contingent upon and subject to the Owner's acceptance of all Subcontract Work and the Contractor's receipt of payment from the Owner for the Subcontract Work. The Subcontractor expressly acknowledges that it relies on the creditworthiness of the Owner, and not that of the Contractor, for payment under the Subcontract. It is expressly agreed that any other basis for such nonpayment by the Owner, including the bankruptcy or insolvency of the Owner, will not excuse this condition precedent to payment from the Contractor to the Subcontractor. Subcontractor further agrees that Owner's acceptance of the Subcontract Work and the Owner's payment to the Contractor for the Subcontract Work are express, independent conditions precedent to the Contractor's obligation to make any payment to the Subcontractor and are not merely expressions of the time or manner of such payments.

PAYMENT OBLIGATION

The statutes and case law in jurisdictions which permit pay-if-paid clauses routinely demand a clear expression of the subcontractor's intent to assume the risk of nonpayment by the owner (see *Pay-if-Paid vs. Pay-when-Paid in Construction Contracts: Pay-if-Paid*).

Therefore, this clause contains multiple representations by the subcontractor to eliminate any doubt, including:

- Payment to the subcontractor is expressly and unequivocally contingent on receipt of payment by the contractor from the owner.
- Receipt of payment by the contractor from the owner is a condition precedent to the contractor's obligation to pay the subcontractor.
- This condition precedent is not a mere expression of the time or manner of payment to the subcontractor.
- Subcontractor acknowledges that it is relying on the creditworthiness of the owner, not of the contractor, in seeking payment under the subcontract.

Depending on the jurisdiction, confirming that receipt of payment from the owner is a condition precedent to the obligation to pay the subcontractor may alone be sufficient to confirm that the subcontractor agreed to a pay-if-paid, rather than a pay-when-paid, clause (see, for example, *Transtar Elec., Inc. v. A.E.M. Elec. Servs. Corp.*, 2014-Ohio-3095, ¶ 27, 140 Ohio St. 3d 193, 199, 16 N.E.3d 645, 651 (the use of the term "condition precedent" clearly expresses the intent to shift the risk of nonpayment to the subcontractor and negates the need for any further language to demonstrate the intent to transfer the risk)).

Even where enforceable, a pay-if-paid clause cannot protect a contractor where the owner has refused to make a payment to the contractor as a result of its own nonperformance, unrelated to the subcontractor's performance of its work.

Counsel should review the statutes and case law in the applicable jurisdiction before drafting the subcontract to determine what language is favored by the courts when enforcing pay-if-paid provisions.

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