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The Dreaded “Pay When Paid” Clause:

The problem is very typical: you have just completed your work on a job or delivered your supplies and want your final payment. You are one or two steps removed from the ultimate entity distributing the funds, the owner. The person with whom you have contracted tells you they are having problems getting paid and you won't get paid, if at all, until they get paid.

Subcontractors often find themselves in this dilemma when they try to secure their retainage, typically 5%, withheld until completion of the work. Most business owners, upon being told of this hold up will go back to their office and try to unearth the contract to see what it said about getting paid, never really having secured a good grasp of the issue at the time they signed the contract. They will run into clauses like the following:

“It is specifically understood and agreed that payment is dependent, as a condition precedent, upon the construction manager receiving contract payments, including retainage, from the owner.” This is a “pay when paid” clause or, perhaps more accurately described as a “pay if paid” clause. What it is saying is that you are not going to get paid unless the owner trickles down the money to those who then hired you and, moreover, those who hired you are not responsible if the owner doesn't pay them. Are you stuck out on a lurch? You don't have any privity of contract with the owner. Fortunately, New York's highest court has held that such pay when paid clauses are not enforceable. The reasoning is that such clauses violate New York's Lien Law (§34) as a subcontractor is forced to assume the risk that the owner will fail to pay the general contractor which, in essence, is extinguishing the subcontractor's ability to enforce a lien against the owner.

New York and California are the only states which have voided the pay if paid provisions as against public policy (out of state contracts with such provisions will be honored in New York). It should also be noted that any kind of contractual language which tries to limit or extinguish your lien rights is also not enforceable.

The seeming remedy in this situation would be to put a lien on the project while concurrently commencing an action against the contractor arguing that the “pay if paid” clause is unenforceable. However, if the contract language does not let the person who hired you off the hook for money that doesn't come down from the owner, but rather, merely allows that person to delay payment until paid, you might be sitting around for a while waiting to get paid. The distinction is that a “time for payment” provision has been held not to violate public policy. For example, it has been held that contract provisions which clearly express an intention that the subcontractor will not get paid or even have the ability to sue on a payment bond until all questions relating to the contracts have been resolved and the owner has made final payment under the contract to the general contractor, are valid and enforceable. There must be a clear expression that the delay in payment, relentlessly occurring on construction projects, is meant to be shifted to suppliers or subcontractors. That intent cannot be assumed. It's a nightmare that suppliers and subcontractors, anyone not in direct privity with the owner, have been waking up to for years.

I presently have a case where the owner was going to get governmental funds for a project and then pay my contractor with those funds. The contract stated that my contractor acknowledged that the work to be performed

under the agreement was being funded with governmental funds “. . . and is dependent upon the City's provision of funds and payment of the same to the owner. Owner should have no liability to the contractor for such disbursement or any loss related thereto.” The argument justifying the delay is the contention that this contract simply means that my contractor is not going to get paid until the owner gets his monies from the government. I do not think it reads that cleanly. I think it's a “pay if paid” provision attempting to negate any responsibilities of the owner if government funds don't come through. The problem for my client is that I will be involved in a court battle requiring a judge to interpret that contract and an evitable appeal by whoever loses that decision.

The lesson here is that you have to know your contract. If there are parties further up the chain and payments trickling down, you can bet that there are going to be some payment contingencies, contract language which could arguably hold up you getting paid, at least in part, for years. Sometimes the contract language will be in the main contract rather than in your subcontract, with your subcontract adopting and being subject to the main contract language.

You have to read the contract and understand the nuances as far as payment is concerned. Since you might be bound via higher contracts up the chain you have to get all the contracts. You may also want to have an attorney review these with you. Too often clients do not come to me until the payment train has come to a stop only to realize that any further monies have been derailed by a payment clause they never read or understood in the original instance.