



# CONSTRUCTION PRACTICE GROUP

Legal Information for the Construction Industry

March 2016



The Soto Law Group, P.A.

## TOP TEN CONSTRUCTION CLAUSES PART VI—PAY IF PAID/PAY WHEN PAID

This is the sixth installment in a ten-part series analyzing critical construction clauses. This installment analyzes the "Pay If Paid" and "Pay When Paid" clauses. My first five articles can be found on our blog at <http://sotolawgroup.blogspot.com/>.

### A. Overview and Background

It is hard to understate the significance of the "Paid If Paid" provision (also known as the "Contingent Payment Provision") and its less draconian counterpart, the "Pay When Paid" provision. The "Pay If Paid" Provision permits a general contractor to place the risk of an owner's nonpayment upon its subcontractor notwithstanding the fact that the subcontractor fully performed its obligations and would be otherwise entitled to payment. A properly worded "Pay If Paid" provision can be a lifesaver for a general contractor and financially devastating to a subcontractor if the owner fails to issue payment. A "Pay When Paid" Provision, on the other hand, is simply construed by the courts as fixing a reasonable time for the contractor to pay the subcontractor, but does not excuse the contractor paying its subcontractors altogether.

The distinction between a "Pay If Paid" and "Pay When Paid" Provision is not always readily apparent, so it's important to be able to distinguish between the two. The Florida Supreme Court in *Peacock Constr. Co. v. Modern Air Conditioning, Inc.*, 353 So. 2d 840, 842 (Fla. 1977) stated that in order to shift the risk of payment failure by the owner to the subcontractor, the contract must unambiguously express that intention. This is because small subcontractors, who must have payment for their work in order to remain in business, will not ordinarily assume the risk of the owner's failure to pay the general contractor. See *id.* Examples of unambiguous "Pay If Paid" Provisions that have been upheld by the courts include:

- "No funds will be owed to the subcontractor unless the General Contractor is paid by the owner in accordance to the sworn statement. The subcontractor fully understands that in event of non-payment by the owner to the General Contractor, the subcontractor has legal recourse against the owner . . ." *DEC Electric, Inc. v. Raphael Construction Corp.*, 558 So. 2d 427 (Fla. 1990).
- "[F]inal payment is contingent upon payment to the contractor." *Robert F. Wilson, Inc. v. Post-Tensioned Structures, Inc.*, 522 So. 2d 79 (Fla. 3d DCA 1988)
- "Final payment . . . shall be made within thirty days of completion of the construction project, acceptance of the same by the Owner, and as a condition precedent, receipt of final payment from the Owner." *Dyser Plumbing Co. v. Ross Plumbing & Heating, Inc.*, 515 So. 2d 250 (Fla. 2d DCA 1987)

If a provision is ambiguous, however, it is interpreted as a "Pay When Paid" Provision, fixing a reasonable time for the contractor to pay its subcontractors, even if the owner ultimately does not pay the general contractor. See *Bentley Constr. Dev. Eng'g, Inc. v. All Phase Electric Maintenance, Inc.*, 562 So. 2d 800, 802 (Fla. 2d DCA 1990). Provisions found by courts to be ambiguous, and therefore construed as

"Pay When Paid" Provisions include:

- "Subcontractor shall be entitled to receive all progress payments and the final payment within ten working days after contractor receives payment for such from the owner, except as otherwise provided in the conditions." *Bentley Constr. Dev. Eng'g, Inc. v. All Phase Electric Maintenance, Inc.*, 562 So. 2d 800, 802 (Fla. 2d DCA 1990).
- Final payment to subcontractors to be made "within thirty days after the completion of the work included in this subcontract, written acceptance by the architect and full payment therefor by the owner." *Peacock Constr. Co. v. Modern Air Conditioning, Inc.*, 353 So. 2d 840, 842 (Fla. 1977).
- No payments to be made "until" the contractor is paid by the owner. *Snead Construction Corp. v. Langerman*, 369 So. 2d 591 (Fla. 1st DCA 1978):

Although it may not be readily apparent from these cases, the primary distinction between a "Pay If Paid" and a "Pay When Paid" clause appears to be whether or not it unambiguously places the subcontractor on notice that payment by the owner is not guaranteed, and in the event payment is not received, the risk of nonpayment lies with the subcontractor. An unambiguous "Pay If Paid" Provision typically uses words like "contingent" or "condition precedent," whereas a typical "Pay When Paid" provision tends to assume that the owner will pay the general contractor and simply sets a time for payment to subcontractor. Importantly, "Pay When Paid" clauses do not expressly and unambiguously state what occurs if the owner fails to issue payment.

## **B. Sample "Pay When Paid" Clauses**

Neither the American Institute of Architects nor ConsensusDocs--two of the foremost authorities on construction contracting--contain a model "Pay If Paid Provision" in their form contracts between general contractors and subcontractors. However, both contain "Pay When Paid" Provisions. For example, The American Institute of Architects' Standard Form of Agreement Between Contractor and Subcontractor (AIA Document A401-2007), includes the following provision at § 11.3:

§ 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.

The ConsensusDocs 750 Standard Agreement Between Constructor and Subcontractor provides the following provision at § 8.2.5:

8.2.5 TIME OF PAYMENT Progress payments to the Subcontractor for satisfactory performance of the Subcontractor 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.

## **C. Negotiation Strategies**

### For the General Contractor

The "Pay If Paid" Provision can be extremely advantageous to the general contractor and is highly recommended. There are a few steps that can be taken to maximize the effectiveness of your "Pay If Paid" Provision. First, ensure that the provision is unambiguous to ensure judicial enforcement. As discussed above, phrases like "receipt of payment from the Owner is a condition precedent" or "payment is contingent upon payment to the contractor" are typically necessary for a "Pay If Paid" Provision to be effective. Consultation with an attorney experienced in drafting "Pay If Paid" clauses is highly recommended to ensure it is enforceable.

Second, ensure that the provision does not conflict with either: (a) other provisions of the subcontract; or (b) provisions of other documents incorporated by reference into the subcontract. There are numerous cases in Florida holding that an otherwise enforceable "Pay If Paid" provision was unenforceable because the subcontract incorporated documents with conflicting language. For example, in *OBS Co. v. Pace Constr. Corp.*, 558 So. 2d 404, 406 (Fla. 1990), the subcontract incorporated the contract between the owner and general contractor, which required the general contractor to submit an affidavit certifying that its subcontractors had been paid before final payment from the owner became due. (emphasis added). The Florida Supreme Court found that this provision created an ambiguity, which must be construed in favor of the subcontractor. See *id.* at 406-407. It is also recommended that the "Pay If Paid" Provision contains language specifying that in the event of a conflict between the "Pay If Paid" Provision and other terms contained or incorporated into the contract, the terms of the "Pay If Paid" Provision shall prevail.

Third, if the general contractor has issued a payment bond for a private project, the general contractor must understand that its surety cannot hide behind the "Pay If Paid" Provision, unless the payment bond is a Conditional Payment Bond and complies with the terms of section 713.245, Florida Statutes. See, e.g., *Everett Painting Co. v. Padula & Wadsworth Constr., Inc.*, 856 So. 2d 1059 (Fla. 4th DCA 2003).

### For the Subcontractor

Obviously, the "Pay If Paid" Provision is extremely dangerous to the subcontractor and should be avoided when possible. A subcontractor should instead attempt to negotiate a "Pay When Paid" provision rather than a "Pay If Paid" provision. Not only does this protect the subcontractor, but also helps the general contractor by providing a reasonable time in which to first attempt to recover payment from owner before issuing payment to the subcontractor.

If the "Pay If Paid" Provision is unavoidable, the subcontractor should do two things: (1) ensure that its lien or bond rights are protected by serving and/or filing all required notices and claims in a timely fashion in compliance with Florida law; and (2) ensure that the subcontractors' downstream contracts with sub-subcontractors and suppliers include a similar provision so that the financial impact of the owners' non-payment is mitigated.

The foregoing is not meant to be an exhaustive discussion of "Pay If Paid" and "Pay When Paid" Provisions and is intended only as a general primer regarding some of the primary issues involving these clauses. Consult with an attorney experienced in drafting "Pay If Paid" and "Pay When Paid" clauses so that together you can negotiate a provision suitable for your business.

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