

Legal Scope

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Pay-if-Paid versus Pay-when-Paid Clauses

“Pay-if-paid clauses” are a notorious point of disagreement when negotiating subcontracts. Sometimes they are referred to as “pay-when-paid clauses;” however, there is a difference between the two.

A pay-if-paid clause governs the risk of non-payment. Under a pay-if-paid clause the general contractor must pay the subcontractor *only if the general contractor was first paid by the owner for the work*. Thus, if the owner fails to pay the general contractor, the subcontractor will not receive payment.

A pay-when-paid clause, on the other hand, governs the *timing* of payment. Under a pay-when-paid clause, the general contractor is still obligated to make payment to the subcontractor, even if the owner fails to pay. Merely, the timing of the subcontractor’s receipt of payment may be delayed, if the owner fails to make payment.

The Restatements of Law are a highly influential treatise on contract law. It provides an excellent example of the operative effects of these clauses:

General Contractor contracts with Subcontractor for work on a construction project. Subcontractor is to receive \$100,000, “no part of which shall be due until five days after Owner shall have paid General Contractor therefor.” Subcontractor does the work, but the Owner becomes insolvent and fails to pay. The General Contractor is still under a duty to pay Subcontractor after a reasonable time. Adopted from Restatements (Second) 227 (illustration 1).

The above hypothetical clause is a “pay-when-paid” clause because it only governs the timing of payment. Ultimately, payment is still owed to the subcontractor, even if the owner failed to make payment. To the contrary, a “pay-if-paid” clause will contain special words that specifically express that payment will be made to the subcontractor if, and only if, the general contractor has first received payment from the owner.

Pennsylvania and Maryland courts will interpret pay-if-paid clauses in similar fashion and the clauses are enforceable. But there are some differences in state statutes that affect the legal rights and obligations of construction entities.

In Maryland, the effects of pay-if-paid clauses are limited by statute. Under the mechanics’ lien law, a pay-if-paid clause cannot void the right to file a mechanics’ lien. MD Code, Real Property, 9-113. Further, under Maryland’s Little Miller Act, covering payment bonds on state public projects, a pay-if-paid clause cannot void the right to file a payment bond claim. MD Code, State Finance and Procurement, 17-108. Thus, on Maryland construction projects, an odd result could occur where breach of contract is not viable against a general contractor, but the subcontractor would still have the right to file either a mechanics’ lien claim or a payment bond claim.

Depending on the unique circumstances, there may be other reasons why a pay-if-paid clause is enforceable (or not). When a payment dispute arises on a project, the legal issues are often complex. It is wise to seek legal counsel early to ensure that the claim is timely preserved and pursued.

The Numbers:

7.3%

- January 2018 unemployment rate in the construction industry.
- This is the lowest January unemployment rate in the construction industry in the last decade.
- Construction industry unemployment rate in January 2010 was 24.7%.

Source(s): U.S. Bureau of Labor Statistics Data, Series ID LNU04032231 (Feb. 28, 2018).



313 W Liberty St., Suite 272 | Lancaster, PA 17603 | 717-212-9164

www.bright-lawfirm.com

Legal Scope is written by Jeffrey Bright, an attorney licensed in Pennsylvania and Maryland. For more information, contact Bright Law Firm. This newsletter is not legal advice. Unlike this newsletter, legal advice is specifically tailored to the facts, law and objectives unique to each circumstance. **To join or remove yourself from this subscription list, email jbright@bright-lawfirm.com.**