

APRIL 9, 2012



Pay-If-Paid Clauses: Is yours valid?

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Difference between “pay when paid” and “pay if paid”

A **pay-if-paid clause**, upon the satisfaction of a condition precedent, shifts the risk of payment by the owner for work performed from the general contractor to the subcontractor.

A **pay-when-paid** clause generally obligates the general contractor to make payments to the subcontractor when the general contractor is paid by the owner or within a reasonable time period after receipt of the corresponding payment from the owner. (Pay-when-paid clauses are unenforceable in Florida.)

Standard for evaluating pay-if-paid clauses

The Supreme Court of Florida first looked the validity of a pay-if-paid clause in *Peacock v. Modern Air Conditioning Inc.*, 353 So.2d 840 (Fla. 1977).

The subcontract provided that *Peacock* (general contractor) would pay Modern Air (subcontractor) “[w]ithin **30 days after completion of the work** included in this subcontract, written acceptance by the Architect and full payment therefore by the Owner.”

The court’s ruling started with the premise that the intent in most contractor/subcontractor relationships is that payment by the owner to the general contractor is not a condition precedent to the general contractor’s duty to pay the subcontractors. The court reasoned that 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 contractors. The court held that risk-shifting provision is susceptible to two interpretations:

- 1) as setting a condition precedent
- 2) as fixing a reasonable time for payment.

While the *Peacock* court did not uphold the risk-shifting provision at issue, it left the door open for future courts to do so and set the standard:

There is nothing in this opinion... to prevent parties to these contracts from shifting the risk of payment failure by the owner to the subcontractor. But in order to make such a shift ***the contract must unambiguously express that intention. And the burden of clear expression is on the general contractor.***

The Peacock court also held that the interpretation of whether the pay-if-paid is valid is a question of law. That ruling was confirmed the Supreme Court in *DEC Electric Inc. v. Raphael Const. Corp.*, 553 So.2d 427 (Fla. 1990), where the Court affirmatively answered the following question certified from the 4th District Court of Appeals:

Must all payment provisions in contracts between contractors and subcontractors or suppliers that concern a condition or time of payment provision be construed as a matter of law?

Unenforceable pay-if-paid clauses

The following phrases have been found to be unenforceable:

- Payments will be made for the value of the work installed each week within 7 business days' receipt of payment from the owner.
G.E.L Recycling, Inc. v. Atlantic Environmental Inc., 821 So.2d 431 (Fla. 5th DCA 2002)
- 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 Const. Development & Engineering, Inc. v. All Phase Electric Maintenance, Inc., 362 So.2d. 800 (Fla. 2d DCA 1990)
- No payment for work under this agreement shall be made to the Sub-Contractor until the Owner shall have paid the contractor thereof.
Snead Const. Corp. v. Langerman, 369 So.2d 591 (Fla. 1st DCA 1978)
- Final payment shall be due when the work described in this subcontract is fully completed and performed in accordance with the contract documents is satisfactory to the Owner and Architect and final payment has been made by the Owner.
Charles R. Perry Const. Inc. v. Barry Gibson & Assocs, Inc., 532 So.2d 1221 (Fla. 1st DCA1988)

All of the above clauses were held not to unambiguously express the intent of both parties to shift the risk of nonpayment to the subcontractor.

Enforceable pay-if-paid clauses

The following phrases have been found to be enforceable:

- Subcontractor is relying upon the financial responsibility of Owner in performing the Work. It is understood by Subcontractor that payment for the work is to be made from funds received from Owner by Contractor in respect to the work.

J.J. Shane, Inc. v. Aetna Cas. & Sur. Co., 723 So.2d 302 (Fla. 3d DCA 1998)

- 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 nonpayment by the owner to the General Contractor, the subcontractor has legal recourse against the owner through the mechanics lien laws or other legal procedures of their correct monies due.

DEC Electric Inc. v. Raphael Const. Corp., 553 So.2d 427 (Fla. 1990)

- Subcontractor agrees that all progress payments and final payment to Subcontractor are contingent upon and subject to Owner's acceptance of Subcontractor's work and upon Contractor's receipt of payment from Owner. Subcontractor agrees to accept the risk of non-payment if Contractor is not paid progress payments and/or final payment from Owner, for any reason.***

Int'l Engineering Servs., Inc. v. Scherer Const. & Engineering of Central Florida, LLC, 74 So.3d 531 (Fla. 5th DCA 2011)

***However, even though the court found that the provision would have been enforceable, because the subcontract agreement incorporated the terms of the prime contract that contradicted pay-if-paid provision, the clause was invalid. Practical tip: When drafting, make sure to pay close attention to incorporation clauses.

The above clauses were found to unambiguously express the intent of both parties to shift the risk of nonpayment to the subcontractor.

Effect of pay-if-paid provision on payment bond

The payment bond is a separate agreement, and any inability to proceed against the general contractor does not necessarily prevent recovery against the sureties under the bond. *OBS Co., Inc. v. Pace Const. Corp.*, 558 So.2d 404 (1990).

Unless the terms of the payment bond include or incorporate pay-if-paid language, the bond terms will govern and not be affected by other contractual payment provisions.

To effectively establish a **conditional payment bond**, see the requirements of Florida Statute 713.245.